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# The Indentured Generation: Bankruptcy and Student Loan Debt

Daniel A. Austin

# THE INDENTURED GENERATION: BANKRUPTCY AND STUDENT LOAN DEBT

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* Associate Professor, Northeastern University School of Law. I thank Professors James R. Hackney, Jr., and Karl Klare, both at Northeastern University School of Law, attorneys Susan Grossberg and Adam S. Minsky, and Leiha Maldonado and Wendy Warren for their comments and insights. Thanks also to Northeastern University School of Law for research support, and to Northeastern law students Amanda Blaske, Ralph Gillis, Julie Lee, Matthew Lord, Ben Zalman (Class of 2012), Ian Kasoff, Jeremiah Meyer-O'Day, Kenneth Parker, Samantha Sclafani, Kelly Smith, and Adam Thomas (Class of 2013) for research assistance.

## INTRODUCTION

A generation of Americans has borrowed heavily for their education, and hundreds of thousands of them are deeply in debt. Some thirty-seven million Americans owe a total of approximately one trillion dollars in student loans.[1] They constitute an Indentured Generation as many of them will be burdened with student loan debt for much of their lives.[2]

1. *See* Dennis Cauchon, *Student Loan Debt Surpasses $1 Trillion*, USA TODAY, October 19, 2011, http://usatoday30.usatoday.com/NEWS/usaedition/2011-10-19-studentloans_ST_U.htm.

2. The concept of student borrowers becoming an indentured class is not new. Rep. William D. Ford (D. - Mich.) may have first coined the term during the passage of the 1965 Higher Education Act: "We are producing a class of indentured servants who must work to free themselves from the bondage of

Some will eventually pay their loans, many will default, and others will receive loan modification or partial loan forgiveness. By and large, their participation in the credit economy will be severely limited. Members of the Indentured Generation who are in particularly dire circumstances will turn to bankruptcy for a fresh start. But, with few exceptions, student loan debtors will not get relief through bankruptcy. The relief that is provided for most debts under the United States Bankruptcy Code (Code) is not available for student loan debt.[3] Because of this, education debt servitude will last a lifetime for tens of thousands of the Indentured Generation.

Some experts warn of a student loan bubble,[4] while others downplay the potential of a mortgage-loan style meltdown.[5] Nonetheless, the numbers associated with

educational debts. . . . How will the next generation afford a home or car if their disposable income is committed to paying off student loans?" Janet Lorin, *Indentured Students Rise As Loans Corrode College Ticket*, BLOOMBERG.COM, July 9, 2012, http://www.bloomberg.com/news/2012-07-09/indentured-students-rise-as-loans-corrode-college-ticket.html. In 1989, Senator Claiborne Pell, Chairman of the Labor and Human Resources Subcommittee on Education, Arts, and Humanities, warned that students who completed college with large debts were at risk of becoming a "new class of indentured servants." Catherine M. Millett, *How Undergraduate Loan Debt Affects Application and Enrollment in Graduate or First Professional School*, 74 J. HIGHER EDUC. 386, 386 (2003).

3. *See infra* notes 230–253 and accompanying text.

4. *See, e.g.*, NAT'L ASS'N OF CONSUMER BANKR. ATT'YS, *STUDENT LOAN DEBT CRISES SURVEY* i, (2012), *available at* http://nacba.org/Portals/0/Documents/Student%20Loan%20Debt/020712%20NACBA%20ststude%20loan%20survey.pdf. The report notes that eighty-one percent of consumer bankruptcy attorneys say that clients with student loan debt have increased noticeably within the past four years, and that the effective lack of bankruptcy discharge for these debts prevents debtors from obtaining a financial fresh start. *See also* Daniel Wagner, *CFPB: Private Student Loans Parallel Subprime Mortgage Lending*, HUFFINGTON POST, July 20, 2012 http://www.huffingtonpost.com/2012/07/20/cfpb-private-student-loans-subprime-mortgage_n_1688771.html. The article states that private student loan lenders gave loans without regard to whether students could pay, then bundled and resold the loans. *Id.* Of course, the federal government also makes loans for education without regard to whether the borrower can repay.

5. *See, e.g.*, Morgan Housel, *Student Loan Bubble: Not as Bad as it Looks*, DAILY FIN., June 1, 2012, http://www.dailyfinance.com/2012/06/01/student-loan-bubble-not-as-bad-as-it-looks/. The article states that, from 2000 to 2010, the average debt per borrower for bachelor degree recipients at public colleges increased only 1.1% above inflation, and 2.2% above inflation at private nonprofit colleges. *Id.* In contrast, mortgage debt during the housing bubble increased at 10% above the rate of inflation. *See also* Tami Luhby, *There is No Student Loan 'Crises,'* CNN MONEY, Mar. 30, 2012,

education debt are staggering. Thirty-seven million Americans—some 15.4% of American households—owe student loans.[6] The average debt load for a four-year college graduate in the class of 2010 was more than $25,250.[7] Students in graduate school borrow much more, averaging over $43,500[8] and individual loan debt exceeding $150,000 is not uncommon.[9] Many middle-aged and senior citizens also have student loan debt, in addition to parents and relatives who have co-signed student loans.[10] As of 2012, less than 40% of student loan debt was in repayment status according to the original terms, and a recent study finds that approximately 21% of current student loans are delinquent or in default.[11]

Compounding the problem is that new graduates are entering one of the worst job markets in decades. The unemployment rate in 2009 for college graduates was 8.7%, but by 2010 it was at 9.1%.[12] Unable to find jobs, unprecedented numbers of young people are moving in with parents, postponing marriage and children, working unpaid, temporary, or part-time jobs, and taking similar steps that

http://money.cnn.com/2012/03/30/news/economy/student-loans/index.htm. The article asserts that most student loan debt is manageable, and that only 10% of borrowers have more than $45,000 in loans.

6. Meta Brown et al., *Grading Student Loans*, FED. RESERVE BANK OF N.Y. (July 9, 2012), http://libertystreeteconomics.newyorkfed.org/2012/03/grading-student-loans.html/. A chart showing the increase in households with education loan debt is in FEDERAL RESERVE BANK 2010 SURVEY OF CONSUMER FINANCES (SCF) CHARTBOOK 1082 (July 19, 2012), *available at* http://www.federalreserve.gov/econresdata/scf/files/2010_SCF_Chartbook.pdf.

7. INST. FOR COLL. ACCESS & SUCCESS, STUDENT DEBT AND THE CLASS OF 2010, at 1, (Nov. 3, 2011), *available at* http://projectonstudentdebt.org/pub_view.php?idx=791.

8. Annamarie Andriotis, *Grad School: Higher Degrees of Debt*, WALL ST. J., May 16, 2012, http://online.wsj.com/article/SB10001424052702304192704577406652556893064.html.

9. For example, medical students graduating in 2011 had average debt of $162,000. *See* AAMC MEDICAL STUDENT EDUCATION: COSTS, DEBT, AND LOAN REPAYMENT, Oct. 2011, *available at* https://www.aamc.org/download/152968/data/debtfactcard.pdf. Law school grads the same year averaged $100,584, with some schools as high as $165,000. Sam Favate, *Law Students, How Much Debt Do You Want?*, WALL ST. J. BLOGS (Mar. 23, 2012), http://blogs.wsj.com/law/2012/03/23/law-students-how-much-debt-do-you-want/.

10. *See infra* notes 43–46 and accompanying text.

11. Brown et al., *supra* note 6. This does not include loans that have already been charged off.

12. INST. FOR COLL. ACCESS & SUCCESS, *supra* note 7, at 1.

would have been unthinkable for prior generations.[13] As a result of financial stress, student loan debtors experience high levels of personal depression, family dysfunction, adverse health effects, and delay major purchases.[14]

While federal repayment and loan forgiveness programs can help some borrowers, for many debtors, these measures fall far short of addressing the crushing burden of student loan debt. But there is an effective means to address the problem. Consumer bankruptcy under the Code adjudicates millions of dollars of debt each day.[15] But the Code excludes education loans from discharge unless the debtor proves that paying the debt would result in undue hardship.[16] The purpose of this policy is to prevent students from fraudulently obtaining student loans and then speedily discharging them upon graduation, as well as to ensure that there is a pool of funds for access to higher education.[17] Consequently, courts have found that undue hardship is a very strict standard for which few debtors qualify.[18]

Consumer bankruptcy can serve an important role in addressing the problem of student loan debt, while at the same time remaining true to the purposes behind the no-discharge policy. The Bankruptcy Code should be amended to allow a student loan to be revalued to the actual fair market value of the loan. The fair market value would be nondischargeable, and the remaining balance of the loan would be dischargeable as general unsecured debt. This ensures that debtors who can pay their student loans will do so, and will help alleviate some of the misery of the Indentured Generation.

The Article will proceed as follows: Part I introduces the Indentured Generation, including an overview of the student loan industry, repayment and forgiveness programs, current repayment and default trends, and profiles of individual

13. *See infra* Part I.D.

14. *See infra* notes 464–76 and accompanying text.

15. Over 1.4 million consumer bankruptcy cases were filed in FY 2011. *Bankruptcy Filings Down in Fiscal Year 2011*, U.S. COURTS (Nov. 7, 2011), *available at* http://www.uscourts.gov/News/NewsView/11-11-07/Bankruptcy_Filings_Down_in_Fiscal_Year_2011.aspx.

16. 11 U.S.C. § 523(a)(8) (2012).

17. *See infra* notes 254–56 and accompanying text.

18. *See infra* Part II.B.4.

debtors. Part II looks at how student loan debt is treated in bankruptcy, including the various tests developed by courts to determine undue hardship. Part III considers the economic and social implications of a student loan indentured class. Part IV offers a partial solution to the student loan crises by amending the Code to allow education loan debt to be modified to its fair market value, with the remainder treated as dischargeable debt.

## I. THE INDENTURED GENERATION

### *A. Mortgaging the Future: Education Cost and Education Debt*

Since 1990, the cost of education has mushroomed far in excess of the cost of living. In 1990–91, the cost of tuition, including room and board, at an average four-year public college was $8495, and $21,423 at a private four-year college.[19] As of 2000–01, this increased to $10,711 for a public college, and $27,054 for a private one.[20] By 2011–12, these numbers were $17,131 and $38,589, respectively.[21] For another perspective, in January 2000, the cost of education and the consumer price index (CPI) were both at 100.[22] As of July 2012, CPI stood at 135, while the cost of education had increased to 196.[23] The cost of a college education has risen by three times the cost of inflation since 1983.[24] Overall, the cost of higher education in America is among the highest in the world.[25]

19. NAT'L CTR. FOR EDUC. STATISTICS, *Fast Facts*, *available at* http://nces.ed.gov/fastfacts/display.asp?id=76, (last visited Apr. 12, 2013).

20. *Id.*

21. STANDARD & POOR'S, STUDENT LOAN ABS TRENDS, OUTLOOK AND PANEL DISCUSSIONS, (2012) at 11, *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_61912slides.pdf.

22. *Id.* at 12.

23. *Id.* at 11; *see also*, U.S. DEP'T OF EDUC., STUDENT LOANS OVERVIEW, FISCAL YEAR 2013 BUDGET REQUEST, at R-18, *available at* http://www2.ed.gov/about/overview/budget/budget13/justifications/r-loansoverview.pdf. For the period 2000–01 to 2010–11 (in constant 2011 dollars), private 4-year college increased by 27% and public 4-year college increased by 49%. *Id.*

24. *The College-Cost Calamity*, ECONOMIST, Aug. 4, 2012, http://www.economist.com/node/21559936.

25. *See The Indebted Ones*, ECONOMIST, Oct. 29, 2011,

To keep pace with skyrocketing education costs, students have been borrowing in ever greater numbers. In 1990, students took out $11.7 billion in loans to fund their educations.[26] By 2000–01, total education loan debt rose to $43,453,000.[27] As of the first-quarter 2012, federal student loan debt stood at approximately $904 billion with private loans adding another $150 billion, surpassing both consumer credit card debt ($679 billion) and auto loan debt ($737 billion).[28] Students borrowed $103.9 billion in 2010–11 alone.[29] As of 2011, borrowing for education at nonprofit schools averaged 42% of the cost of an education,[30] while the borrowing rate at 2-year for-profit schools may be as high as 98%.[31] The Department of Education expects new federally guaranteed student loans in 2013 to total $154.4 billion.[32] The fastest growth is for students at for-profit schools, even though students at these schools have a lower graduation rate, higher debt, and higher tendency to default on loans.[33]

The amount of debt per student and the percentage of students borrowing for education have both expanded dramatically in recent decades. In 1989–90, students graduating from public four-year colleges averaged $8200 in

http://www.economist.com/node/21534781 (stating that the higher education debt problem in America is far greater than in Britain).

26. U.S. GEN. ACCOUNTING OFFICE, GAO-03-348, REPORT TO THE SECRETARY OF EDUCATION, FEDERAL STUDENT AID: TIMELY PERFORMANCE PLANS AND REPORTS WOULD HELP GUIDE AND ASSESS ACHIEVEMENT OF DEFAULT MANAGEMENT GOALS, 1 (2003), *available at* http://www.gao.gov/assets/240/237348.pdf.

27. *Trends in Student Aid 2012*, THE COLL. BD., 10 (2012), http://trends.collegeboard.org/sites/default/files/student-aid-2012-full-report-130201.pdf [hereinafter *COLL. BD.*].

28. STANDARD & POOR'S, *supra* note 21. See Brown et al., *supra* note 6, for third quarter 2011 data; *see also* Cauchon, *supra* note 1.

29. COLL. BD., *supra* note 27, at 10.

30. *Id.* at 17.

31. U.S. DEP'T OF EDUC., *supra* note 23, at R-18.

32. *See id.* at R-17.

33. STANDARD & POOR'S, *US Student Loan ABS Issuance Is Ticking Up, But the Future Is Uncertain Say Conference Speakers* 2 (2012), *available at* http://www.standardandpoors.com/spf/upload/Events_US/US_SF_Event_619abs10.pdf; Chris Kirkham, *For-Profit College Students Face Higher Debt, More Unemployment, Report Finds*, HUFFINGTON POST (Jan. 4, 2012), http://www.huffingtonpost.com/2012/01/03/for-profit-colleges-unemployment-debt_n_1182164.html.

debt, while average debt at private colleges was $10,600.[34] In 1999 and 2000, the amounts increased to $15,100 and $16,500, respectively.[35] But over the decade, 2000–02 through 2010–11, federal loans per full-time undergraduate student shot up at an average rate of 5% a year after adjusting for inflation, for a total increase of 57% for the decade.[36] As of 2010, 55% of students at public four-year colleges had borrowed for education, with an average debt of $22,000.[37] Of students earning bachelor's degrees at private nonprofit institutions, about 66% had borrowed for their education, and the typical debt load was $28,100.[38] Averaging all four-year nonprofit schools, the mean debt per student in 2010 was $25,250.[39] A typical undergraduate student received $4907 in federal loans in 2010–11, while the average graduate student received $16,423 in federal loans during the same period.[40] For graduates obtaining professional degrees, the borrowing rate was much higher, with some 79% having obtained loans for school as of 2007–08.[41] The plight of law school graduates, with an average debt load of $98,500 at graduation in 2010, has been well-noted in the press.[42] And none of the numbers cited here include private loans, which are more difficult to track.

It is not just younger people who go into debt for education. In recent years, education borrowing by people ages thirty-five to forty-nine has also grown rapidly.[43] In addition, parents are incurring debt to cover college costs for

34. HEATHER BOUSHEY, THE DEBT EXPLOSION AMONG COLLEGE GRADUATES, CENTER FOR ECONOMIC AND POLICY RESEARCH 2 (March 2003), *available at* http://www.cepr.net/documents/publications/Student_Debt_Issue_Brief.pdf.

35. *Id.*

36. COLL. BD., *supra* note 27, at 3, 4.

37. *Id.* at 4.

38. *Id.*

39. INST. FOR COLL. ACCESS & SUCCESS, *supra* note 7.

40. COLLEGE BOARD., *supra* note 27, at 3.

41. JENNIE H. WOO, THE EXPANSION OF PRIVATE LOANS IN POSTSECONDARY EDUCATION, 13 (2011), *available at* http://nces.ed.gov/pubs2012/2012184.pdf.

42. *See* Lincoln Caplan, *An Existential Crises for Law Schools*, N.Y. TIMES, July 14, 2012, http://www.nytimes.com/2012/07/15/opinion/sunday/an-existential-crisis-for-law-schools.html?src=recg&pagewanted=print.

43. Mitch Lipka, *Middle-Aged Borrowers Piling on Student Debt*, REUTERS, Dec. 27, 2011, http://www.reuters.com/article/2011/12/27/us-studentdebt-middleage-idUSTRE7BQ0T620111227.

their children. In 2010, 17% of parents took out loans for their children's education, up from 5.6% in 1992–93.[44] Loans to parents, for their children's college education, account for approximately $100 billion, or about 10% of the estimated $1 trillion in education debt.[45] And many older people remain saddled with debt from their own college years. One study finds that people aged sixty and older hold $36 billion in student loan debt, of which some 10% is delinquent.[46]

Borrowing rates are different at for-profit programs than at public and private institutions.[47] For example, as of 2009, only 15% of students who started post-secondary studies at a four-year for-profit institution had earned a degree, and of those graduates, two-thirds had debt over $28,000.[48] In contrast, for dependent students who started at a public four-year institution, 64% had earned a bachelor's degree, but only 14% of them borrowed more than $28,000.[49] In 2008, students at proprietary schools studying for an associate's degree had median federal debt of approximately $14,045, compared to median debt level of $7125 for students at private, not-for-profit schools.[50] Similarly, students seeking a bachelor's degree at proprietary four-year schools had a median debt of $23,874, more than double the debt level of $11,580 for students at private nonprofit schools, and five times the debt of $4968 for students at public schools.[51]

Student loan debt is clearly concentrated in young adults. As of the third-quarter of 2011, the total number of people in the United States with student loan debt was

44. Janet Lorin, *Parents Snared in $100 Billion College Debt Trap Risk Retirement*, BLOOMBERG, Feb. 2, 2012, http://bloomberg.com/news/2012-02-02/parents-snared-in-100-billion-u-s-college-debt-trap-risking-retirement.html.

45. *Id*.

46. Karen Datko, *Over 60 and Still Paying Student Loans*, MSN MONEY, Apr. 5, 2012, http://money.msn.com/saving-money-tips/post.aspx?post=d921ed1b-2cda-4cdf-8289-9b6ec2ccc309&_blg=35.

47. *See Degrees of Debt*, N.Y. TIMES, http://www.nytimes.com/interactive/2012/05/13/business/student-debt-at-colleges-and-universities.html?ref=business (last updated May 12, 2012) (containing an interactive chart of average costs and average student debt based upon the university). All cost data on the chart is provided by the respective schools, and many schools do not participate. *See id.*

48. COLL. BD., *supra* note 27, at 18.

49. *Id.*

50. U.S. DEP'T OF EDUC., *supra* note 23, at R-22.

51. *Id.*

approximately $37 million.[52] Of people under the age of thirty, 40.1% have student loan debt, while among people between the ages of thirty and thirty-nine, 25.1% have student loan debt.[53] In contrast, only 7.4% of people over forty have student loan debt.[54] Overall, people under the age of forty owe $580 billion of the $870 billion federal student loan balance.

### *B. The Student Loan Industry*

The student loan industry is a massive, profit-making enterprise. With loan assets of $1 trillion, and lending in 2013 exceeding $150 billion,[55] the student loan business eclipses almost any private industry in annual sales.

#### *1. Federal Loan Programs*

Federal funding for student loans began as a response to the Cold War and the launch of the Soviet Sputnik satellite in 1957.[56] Initially, the government made direct loans under the National Defense Education Act of 1958.[57] Subsequent expansion of federal loan programs included the Guaranteed Student Loan Program (GLS) (1965) in which the government guaranteed loans provided by private sources,[58] Education Amendments of 1972 (1972) to provide grants and loans for junior colleges, trade schools, and career colleges,[59] the Middle Assistance Act (1978) offering education grants and loans to middle-class families,[60] and the Parent Loans for

52. Brown et al., *supra* note 6.

53. *Id.*

54. *Id.*

55. U.S. DEP'T OF EDUC., *supra* note 23, at R-3. New loans will be $121 billion, consolidations will be $28 billion, and private loans (15% of all student loans) will constitute the rest. *Id.*

56. Gareth Marples, *The History of Student Loans—Financial Aid for Economic Competition*, THE HISTORY OF NET (Sept. 11, 2008), http://thehistoryof.net/history-of-student-loans-html.

57. *See Federal Student Loan Programs—History*, NEW AM. FOUND., http://febp.newamerica.net/background-analysis/federal-student-loan-programs-history (last visited on Mar. 9, 2013).

58. Higher Education Act of 1965, Pub. L. No. 89-329, § 430(a), 79 Stat. 1219 (1965).

59. Education Amendments Act of 1972, Pub. L. 92-318, § 302(a)(1), 86 Stat. 241–42 (1972).

60. Middle Income Student Assistance Act, Pub. L. No. 95-566, § 2, 92 Stat. 2402 (1978).

Undergraduate Students Program (1980), which allowed families of all income levels to obtain loans for dependent students, albeit at higher interest rates.[61] In 2007, the College Cost Reduction and Access Act increased Pell grant amounts, reduced interest rates on subsidized student loans, and capped loan repayment at 15% of discretionary income.[62]

The GSL program was revised in 1988 to become the Federal Stafford Loan Program.[63] Through 1993, private banks made student loans under the Stafford program, and the Department of Education would subsidize loans and reimburse banks if borrowers defaulted.[64] The Stafford program was modified in 1993 with the creation of the Federal Family Education Loan Program (FFELP)[65] and the William D. Ford Federal Direct Loan program.[66] FFELP continued the policy of students obtaining federally guaranteed loans through banks. However, under the Ford loan program, students borrowed funds directly from participating schools, which received funds from the Department of Education.[67] From 1993 to 2010, applicants for a Stafford loan could get their loans through either the Ford program or FFELP.[68] Approximately 73% of all federal student loans were made through FFELP.[69] Lenders under FFELP made loans without regard to the student's creditworthiness.[70] The federal government guaranteed the loan against default.[71] Today, federal loans constitute about 85% of all outstanding education loan debt,[72] and

61. Education Amendments Act of 1980, Pub. L. No. 96-374 Section 419, 94 Stat. 1424 (1980).

62. College Cost Reduction and Access Act, Pub. L. No. 110-84, §§ 102, 201, 121 Stat. 784–85, 790, 792 (2007).

63. 20 U.S.C. § 1071(c).

64. 20 U.S.C. § 1080.

65. 34 C.F.R. § 682.100–.800 (2012).

66. 20 U.S.C. § 1087a.

67. 20 U.S.C. § 1087b(a).

68. *See Federal Family Education Loan (FFEL) Program*, U.S. DEP'T OF EDUC., http://www2.ed.gov/programs/ffel/index.html (last updated July 1, 2010).

69. *See* COLL. BD., *supra* note 27, at 10.

70. 20 U.S.C. § 1078(c)(2)(F) (2012); 34 C.F.R. § 682.404(h)(1) (2012).

71. 20 U.S.C. § 1071 (2012).

72. Private Student Loans, Consumer Fin. Prot. Bureau, 9 (July 20, 2012), http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf.

approximately 93% of all new loans.[73]

To entice private lenders to make loans to students, FFELP lenders were promised a guaranteed rate of return called the special allowance rate, based upon an average of three-month commercial paper rates, plus certain factors for loans in repayment, in deferment, or in a grace period.[74] This was in addition to the federal loan guarantee if the borrower defaulted.

A major restructuring of student loans took place in 2010 with the enactment of the Health Care and Education Reconciliation Act.[75] The Act contains the Student Aid and Fiscal Responsibility Act (SAFRA).[76] A key provision of SAFRA is to remove private banks as middlemen in the student loan process, which is intended to save the cost of subsidies and guarantees paid to banks, and then redirect that savings to need-based grants.[77] Loans are now made directly to students through the U.S. Department of Education, ending the FFELP program.[78] For loans made before 2010, lenders receive the higher of the special allowance rate or the student interest rate set by the government for new student loans.[79] If the student rate is lower than the special allowance rate, the government makes up the difference.[80] In the event that the student rate is higher, the lender pays the difference to the government.[81]

Currently, the federal government originates four types of loans: Subsidized Stafford, Unsubsidized Stafford, PLUS, and Consolidation loans.[82] The Subsidized Stafford loan

73. *Id.*

74. U.S. DEP'T OF EDUC., *supra* note 23, at R-8, R-9. While the specific rate could change for some loans, interest was capped at 8.25% for Stafford and Consolidation loans, and 9% for PLUS loans. *Id.* at R-9.

75. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

76. Student Aid and Fiscal Responsibility Act of 2009, H.R. 3221, 111th Cong. (2009).

77. Under SAFRA, the role of private banks will be to service loans. Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 2201-05, 124 Stat. 1029, 1074–75 (2010).

78. *See Federal Family Education Loan (FFEL) Program*, *supra* note 68.

79. U.S. DEP'T OF EDUC., *supra* note 23, at R-8.

80. *Id.*

81. *Id.* at R-8, R-9.

82. *Id.* at R-4.

offers the lowest interest rate, presently at 3.4%.[83] Borrowers must meet a financial needs test based on family income, and after July 1, 2012, graduate and professional students are no longer eligible for these loans.[84] The three other types of loans are available to borrowers at any income level.[85] Previously, the government paid the interest on the loan during the time the student was in college, as well as a six-month grace period following graduation, and for any deferment periods.[86] However, as of July 1, 2012, students are charged interest immediately following graduation.[87]

Unsubsidized Stafford loans are made without regard to financial need.[88] The interest rate is 6.8% for loans made after July 1, 2006, and the government does not pay any of the interest.[89] Students can defer payment of interest while in school, but accrued interest will be capitalized at the start of repayment.[90] PLUS Loans (Parents Plus) are available to parents with dependant undergraduate, graduate, and professional degree students. Interest is 7.9% and accrues immediately upon disbursement of the loan.[91] Plus Loan applicants may not have any adverse credit history.[92] Consolidation Loans are available for borrowers with existing loans in order to combine the loans and extend payment schedules and terms based on their total existing loans.[93] The interest on a Consolidation Loan is based upon the weighted average of all loans being consolidated, rounded up to the

83. *Id.* This rate was part of a phased reduction in rates from 6.8% in 2007 to 3.4% from July 1, 2011 to July 1, 2012. The rate was scheduled to revert to 6.8%, but a last-minute agreement to extend that 3.4% rate for one year was reached in the Senate shortly before on the rate increase was to take effect. REUTERS, *No More Grace Period on Student-Loan Interest*, CHI. TRIBUNE, June 28, 2012, *available at* http://www.chicagotribune.com/business/breaking/chi-no-more-grace-period-on-student-loans-20120628,0,4384922.story.

84. U.S. DEP'T OF EDUC., *supra* note 23, at R-4.

85. *Id.*

86. REUTERS, *supra* note 83.

87. *Id.*

88. *Subsidized and Unsubsidized Loans*, U.S. DEP'T OF EDUC., http://studentaid.ed.gov/types/loans/subsidized-unsubsidized#what%27s-the-difference (last visited Apr. 13, 2013).

89. U.S. DEP'T OF EDUC., *supra* note 23, at R-6.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

nearest 1/8 of 1%.[94]

Subsidized and Unsubsidized Stafford Loan amounts are capped as follows[95]:

| | Annual Limits | Annual Limits |
|---|---|---|
| **Dependant Undergraduates** | **Stafford** | **Total (Stafford & Unsubsidized Stafford)** |
| First-Year Student | $3500 | $5500 |
| Second-Year Student | $4500 | $6500 |
| Third-Year Student | $5500 | $7500 |
| **Independent Undergraduates** | | |
| First-Year Student | $3500 | $9500 |
| Second-Year Student | $4500 | $10,500 |
| Third-Year Student | $5500 | $12,500 |
| **Graduate Students** | $8500 | $20,500 |
| | **Aggregate Limits** | **Aggregate Limits** |
| **Dependant Undergraduates** | $23,000 | $31,000 |
| **Independent Undergraduates** | $23,000 | $57,500 |
| **Graduate Students** | $65,500 | $138,500 |

Education lending is an income-producing endeavor for the federal government. Profit is made on the spread between the government's borrowing rate, presently around 1%, and the subsidized lending rate, currently at 3.4% for the lowest rate Subsidized Stafford loan and increasing with other types of loans.[96] This is in addition to the origination fee of 1%.[97] The Department of Education anticipates that federal subsidized student loan activity (including new loans and consolidation of existing loans) will generate $38.9 billion in revenue for the government in 2012, and approximately

94. *Id.*
95. *Id.* at R-7.
96. *See id.* at R-3, R-4.
97. *Id.* at R-4.

$36.8 billion in 2013.[98] The federal government expects to earn 20.08% on each dollar of loans originated in 2013.[99]

*2. Non-federal Student Loans*

In addition to federal education loans, private lenders also loan money to students. About 2.9 million students currently have private loans.[100] Private loans peaked at $22 billion in 2007–08, but dropped to $6 billion in 2010–11 due to increased caps on federal loans and tighter lending standards.[101] Currently, private loans make up about 7% of new borrowing, but overall constitute approximately 15% of total student loan debt.[102] The total of private loans is $150 billion.[103]

A student might take out a non-federal loan if he has reached the annual or aggregate federal loan cap. Unlike federal loans, most non-federal loans are priced according to creditworthiness standards, and there is no cap on interest rates.[104] Interest rates on private loans are usually much higher than federal loans,[105] with some as high as 15% or more.[106] Many private loans include adjustable interest rates without caps that are adjustable as interest rates change.[107] There are no loan limits, but there are also no deferments, income-contingent repayment, or any of the other relief available in federal loan programs.[108] Private loans are

98. *Id.* at R-2. The Congressional Budget Office estimates that 2012 loans and consolidations will generate $37 billion in revenue, which is slightly less than the Department of Education estimate. CBO MEMORANDUM, Table 1, Mar. 13, 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/43054_StudentLoanPellGrantPrograms.pdf.

99. U.S. DEP'T OF EDUC., *supra* note 23, at R-14.

100. Janet Lorin, *Students Pay SLM 9.25% on Exploitive Loans for College*, BLOOMBERG, June 5, 2012, http://www.bloomberg.com/news/print/2012-06-05/students-pay-slm-9-25-on-exploitive-loans-for-college.html.

101. *Id*.

102. CONSUMER FINANCIAL PROTECTION BUREAU, *supra* note 72.

103. Blake Ellis, *Private Student Loan Debt Reaches $150 Billion*, CNN MONEY, July 20, 2012, http://money.cnn.com/2012/07/20/pf/college/private-student-loan-debt-cfpb/.

104. NAT'L ASS'N OF CONSUMER BANKRUPTCY ATT'YS, *supra* note 4, at 4. CONSUMER FINANCIAL PROTECTION BUREAU, *supra* note 72 at 12.

105. Lorin, *supra* note 100.

106. CONSUMER PROTECTION PROTECTION BUREAU, *supra* note 72, at 12.

107. *Id.*

108. *Id.* at 12-13.

considered riskier than federally guaranteed loans, yet more than half of student borrowers fail to max out government loans before incurring private loans.[109] Overall, student lending is a highly profitable business.[110]

The largest private student loan lender is SLM Corp. (known as Sallie Mae).[111] Established in 1972, Sallie Mae is financed by borrowing money, then relending to students at a higher rate.[112] Sallie Mae invented Student Loan Asset Backed Securities (SLABS) in the early 1990s.[113] These are securitized portfolios of student loans, similar to Fannie Mae securities backed by home mortgages.[114] The assets behind the securities are the loans themselves.[115] In 1990, there were $75.6 million Sallie Mae securities in circulation, in 2010, annual trading was $250 billion.[116] For 2013, private education lending is exploding, as Sallie Mae alone expects to lend up to $4 billion, a 21% increase from 2012.[117] At present, investor demand for SLABS far exceeds the supply.[118] Up to 30% of student debt is securitized.[119]

Private lenders have been accused of offering schools incentives such as paid trips for financial aid officials and guests to conferences in vacation spots, gifts awarded through raffles, set-asides (loans for international students and those with poor credit), and even cash payments directly to schools in order to encourage schools to steer students to a lender's loan programs.[120] Reform measures subsequently curbed

109. *Id.*

110. *See* Lorin, *supra* note 100 (noting that two companies are expanding their student-loan businesses to capture a growing market).

111. Ruth Simon et al., *Student-Loan Securities Stay Hot*, N.Y. TIMES, Mar. 4, 2013, at C1.

112. William S. Howard, *The Student Loan Crisis and the Race to Princeton Law School*, 7 GEO. MASON J.L. ECON. & POL'Y 485, 503 (2011).

113. *See* Malcolm Harris, *Bad Education*, N+1 MAG., Apr. 25, 2011, *available at* http://nplusonemag.com/bad-education.

114. *Id.*

115. *Id.*

116. *Id.*

117. Kathleen M. Howley, *American Dream Eludes With Student Debt Burden: Mortgages*, Bloomberg.com (April 13, 2013), p. 4, http://www.bloomberg.com/news/print/2013-04-12/american-dream-eludes-with-student-debt-burden-mortgages.html (noting that higher education debts.

118. Simon et al., *supra* note 111.

119. *Id.*

120. Kelly Field, *The Selling of Student Loans*, CHRONICLE OF HIGHER EDUCATION, June 1, 2007, at A15, *available at* http://chronicle.com/article/The-

some, but not all, of these abuses.[121]

### *3. Student Loans and Higher Education Costs: Cause, Effect, and Cause Again*

Some commentators assert that the broad availability of education credit has itself fueled the increase in education costs. Known as the Bennett Hypothesis, it postulates that increases in education credit creates more students with funds to go to college, so schools raise tuition in order to capture the increase in federal money.[122] It was first articulated by William Bennett, Education Secretary under Ronald Reagan, who wrote in a 1987 op-ed piece, "increases in financial aid in recent years have enabled colleges and universities to raise their tuitions, confident that Federal loan subsidies would help cushion the increase."[123] As colleges charge more, school loan credits must increase in order to keep pace with education costs, and the cycle repeats.[124] Higher tuition rates and loans to pay them have spurred building booms at universities across the United

Selling-of-Student-Loans/12437/; Jonathan D. Glater, *Offering Perks, Lenders Court Colleges' Favor*, N.Y. TIMES, Oct. 24, 2006 http://www.nytimes.com/2006/10/24/education/24loans.html?_r=1&pagewanted=print.

121. *See* Jonathon D. Glater, *The Other Big Test: Why Congress Should Allow College Students to Borrow More Through Federal Aid Programs*, 14 N.Y.U. J. LEGIS. & PUB. POL'Y 11, 51–54 (2011) (describing Congress's response to the student lending industry tactics).

122. *See* Paul Kix, *Does Financial Aid Make College More Expensive?* BOSTON GLOBE, Mar. 25, 2012, http://articles.boston.com/2012-03-25/ideas/31228641_1_financial-aid-federal-aid-college-tuitions. The article discusses the Bennett Hypothesis and its critics. *Id.*

123. William J. Bennett, *Our Greedy Colleges*, N.Y. TIMES, Feb. 18, 1987, http://www.nytimes.com/1987/02/18/opinion/our-greedy-colleges.html. Another commentator has colorfully opined: "Colleges 'suddenly saw the government as this giant wobbling teat just waiting to be sucked, and started a spastic race towards Who Cold Charge the Most Ludicrous Tuition For Four Years . . . .'" Roger Roots, *The Student Loan Debt Crisis: A Lesson in Unintended Consequences*, 29 SW. U. L. REV. 501, 506 n.23 (2000) (quoting Ian William, *The Indentured Class: Student Loans Are Robbing Us of Our Future*, THE PROVIDENCE PHOENIX, Sept. 20, 1996, at 8).

124. *See* Katharina Ley & Jussi Keppo, The Credits That Count: How Credit Growth and Financial Aid Affect College Tuition and Fees 21 (Nov. 16, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstracts=1766549. The authors conclude that increased loan funds and grants allow schools to charge more, which in turn feeds demand for additional loans and aid. *Id.*

States[125] and allowed programs that utilize federal loan funds to charge far more than programs that do not.[126] Proponents of the Bennett Hypothesis assert that the upward trend in education costs will not be contained as long as low-cost student loans are available.[127] One commentator even claims that although federal loan programs are intended to make college accessible regardless of economic background, the effect has been increased stratification in the availability of higher education.[128]

### *C. Repayment and Forgiveness of Student Loans*

It is not uncommon for students in school to mentally compartmentalize the fact that they will eventually have to repay the loans.[129] Even after graduation, Stafford loans allow for a grace period of six months after graduation, or if the student leaves the program or drops below part-time.[130] Upon expiration of the grace period, it is time to repay.[131]

125. *See* Janet Lorin, *supra* note 2. The article asserts that as borrowing for college soared in the 2000s, universities began a multi-billion dollars building boom. Concurrently, the debt of some 500 colleges and universities rated by Moody's Investor Services rose from $91 billion in 2002 to $211 billion by 2011. *Id.*

126. *See* Kix, *supra* note 122. The article mentions that according to one study, tuition at for-profit schools that offer federal loans is 75% more expensive than at schools with no federal loans. *Id.*

127. *See, e.g.*, Andrew Gillen, *Introducing Bennett Hypothesis 2.0*, Feb. 2012, *available at* http://centerforcollegeaffordability.org/uploads/Introducing_Bennett_Hypothesis_2.pdf. Gillen purports to draw a clear line between federal education loan credits and increased college tuition, and asserts that the only way to avoid increases in education costs is to limit education loans to only students with demonstrable financial need. *Id.* at 7; *see also*, Howard, *supra* note 112 at 505 ("As long as student loans are made without any analysis of ability to repay, more and more money will flood the system and inflate the prices.").

128. Roots, *supra* note 123, at 524 ("Far from the egalitarian results contemplated by the original proponents of the guaranteed student loan program, the final effect of the program has been the growth, rather than the reduction, of socio-economic disparity between races, classes, and ethnic groups.").

129. *See, e.g.*, the story of Debtor 1, *infra* Part I.D.1.i.

130. ALISA F. CUNNINGHAM & GREGORY S. KIENZL, DELINQUENCY: THE UNTOLD STORY OF STUDENT LOAN BORROWING 13 (2011), *available at* http://www.ihep.org/Publications/publications-detail.cfm?id=142.

131. There are a number of online calculators to determine monthly payments on a loan. The Department of Education calculator for federally guaranteed loans is at *Calculators and Interest Rates*, E.D.GOV, http://www.direct.ed.gov/calc.html (last visited Apr. 12, 2013).

There are different modes for doing so.

The Standard Repayment program requires a fixed amount per month of at least $50, and allows up to ten years to repay a loan.[132] This gives the shortest repayment period but the highest monthly amount. Students with federal loans in excess of $30,000 may qualify for Extended Repayment.[133] This allows up to twenty-five years for repayment, with the option of either fixed or graduated repayment.[134] Fixed repayment is the same amount each month, while graduated repayment starts lower, but increases in amount every two years.[135] Repayment may take up to ten years, and no single payment will ever be more than three times any other payment.[136]

For students struggling to meet any of the above repayment options, there is the Income Contingent Repayment program. This is only available for loans made under the Federal Direct Loan Program, so a Parent Plus loan is not eligible.[137] Each year, the monthly payment amount is calculated based on adjusted gross income (AGI) (including spouse's income if the borrower is married), family size, and total amount of Direct Loans.[138] A set formula determines the amount of the monthly payment, but it is not more than 20% of the debtor's monthly discretionary income, which is calculated based on AGI minus poverty levels for the debtor's state of residence and family size, divided by twelve.[139] If the payments are not large enough to cover the accumulated interest on the loan, the interest is capitalized once a year.[140] However, capitalization of the interest will not exceed 10% of the original amount owed when the debtor entered repayment.[141] Interest will continue to accrue

132. *See Repayment Plans*, U.S. DEP'T OF EDUC., http://www.direct.ed.gov/RepayCalc/dlindex2.html (last visited Apr. 12, 2013) (discussing repayment options).
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.*
138. *Id.*
139. *Id.*
140. *Id.*
141. *Id.*

thereafter, but will not be capitalized.[142] The maximum payment time is twenty-five years, and then the unpaid portion is forgiven.[143] Any time spent in deferment or forbearance does not count towards the twenty-five years.[144] And, any amount that is forgiven can potentially be treated as taxable income of the debtor.[145]

Another option is Income-Based Repayment (IBR). A debtor is eligible for IBR if she would have to pay more under a standard ten-year repayment plan than under the IBR formula.[146] "The required payment is 1/12 of the annual payment, and the annual payment is 15[%] of the borrower's discretionary income, as defined by the borrower's adjusted gross income (AGI), minus 150[%] of the federal poverty level for a family that is the size of the borrower's family."[147] For example, a single law graduate borrower with no dependents, debt of $123,000 at 6.8%, and annual income of $50,000 would pay $421 per month, rather than $1417 per month on a ten-year repayment plan.[148] However, a borrower with two dependants making less than the poverty line of $27,795 will not have to make any payments. Interest continues to accrue, but after twenty-five years, the entire remaining balance is forgiven.[149] Borrowers working in public service jobs may be eligible for loan forgiveness after ten years, with certain

142. *Id.*

143. *Id.*

144. *Id.*

145. 26 U.S.C. § 108 (2012) provides that cancellation of certain types, including loan forgiveness, is taxable as income. However, under § 108(a)(3), debt forgiveness is not taxable as income to the extent the debtor is insolvent at the time of cancellation. *Id.* at § 108(a)(3).

146. *Income-Based Repayment Plan*, U.S. DEP'T OF EDUC., http://studentaid.ed.gov/PORTALSWebApp/students/english/IBRPlan.jsp (last visited Apr. 12, 2013). An on-line calculator is provided for borrowers to determine if they are eligible.

For a comprehensive discussion of IBR, see Philip G. Schrag & Charles Pruett, *Coordinating Law School Loan Repayment Assistance Programs with New Federal Loan Repayment and Forgiveness Legislation*, Georgetown Public Law and Legal Theory Research Paper No. 10-77, at 590, *available at* http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1483&context=facpub.

147. Schrag & Pruett, *supra*, at 590–91 (citations omitted).

148. *Id.* at 591. If married borrowers file a joint tax return, the income of the borrower's spouse is included in the AGI threshold. Therefore, borrowers considering IBR may need to file separately in order to qualify. *Id.* at 593.

149. *Income-Based Repayment Plan*, *supra* note 146.

limitations.[150]

All Stafford, PLUS, and Consolidation Loans made under the Direct Loan or FFELP are eligible for repayment under IBR, except for Parent PLUS loans (PLUS loans that were made to parent borrowers), or Consolidation Loans that repaid Parent Plus Loans.[151] For borrowing that begins in 2014, payments are capped at 10% of income, and the loan balance will be forgiven after twenty years.[152] As with income contingent repayment, the amount that is forgiven is potentially taxable as income.[153] Borrowers on an IBR must submit annual documentation of their continued eligibility for the program and meet other requirements.[154]

There is a special Public Service Loan Forgiveness program for Stafford loans.[155] This allows a debtor to teach for five consecutive years in schools that serve low-income families and receive up to $17,500 in loan forgiveness on FFELP and/or Direct Loan program loans.[156] In addition, some debtors may apply for a FFELP Disability Discharge. To qualify for the discharge, a physician must certify that the borrower is unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that (1) can be expected to result in death; (2) has lasted for a continuous period of not less than sixty months; (3) can be expected to last for a continuous period of not less than sixty months; or (4) has been determined by the Secretary of Veteran Affairs to be

150. *Public Service Loan Forgiveness*, U.S. DEP'T OF EDUC., http://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/public-service (last visited Apr. 12, 2013).

151. *Income-Based Repayment Plan*, *supra* note 146. Public service loan forgiveness is only available for William D. Ford Direct Loans. *Public Service Loan Forgiveness*, *supra*, note 150.

152. Ben Steverman, *Student Loan Debt Leads to Despair—and Defaults*, BLOOMBERG, Oct. 24, 2011, http://www.bloomberg.com/news/2011-10-21/student-loan-debt-leads-to-confusion-protests-and-many-defaults.html.

153. *See Income-Based Repayment Plan*, *supra* note 146. However, public service loan forgiveness is not taxable. *Public Service Loan Forgiveness*, *supra* note 150.

154. *Income-Based Repayment Plan*, *supra* note 146.

155. 34 C.F.R. § 685.219 (2010).

156. *Stafford Loan Forgiveness Program for Teachers*, U.S. DEP'T OF EDUC., http://studentaid.ed.gov/repay-loans/forgiveness-cancellation/charts/teacher (last visited Apr. 12, 2013).

unemployable because of a service-connected disability.[157]

There are several specialized loan forgiveness programs. The Veterinary Medicine Loan Repayment Program (VMLRP) provides for partial loan forgiveness if a veterinary medicine graduate serves in a designated shortage situation.[158] There are loan repayment programs for law graduates who enter into public or low-income service.[159] In addition, military branches have loan repayment programs. The U.S. Army offers up to $65,000 in qualified loan repayment for enlistees, as does the U.S. Navy, while the Air Force offers up to $10,000.[160]

Federal student loans are not subject to any statute of limitations.[161] Private and non-federal loans are subject to regular statute of limitations.[162] A student loan obligation ends if the borrower dies, and her estate is not liable for any balance owed.[163] However, the situation may be different if there is a cosigner. The federal government forgives all education debts if the borrower dies and does not hold the cosigner liable.[164] Private student loan lenders are not

157. U.S. DEP'T OF EDUC., *FFELP Disability Discharge*, *available at* http://www2.ed.gov/offices/OSFAP/DCS/forms/disable.pdf (last visited Apr. 12, 2013).

158. *About the VMLRP*, U.S. DEP'T OF AGRIC., http://www.nifa.usda.gov/nea/animals/in_focus/an_health_if_vmlrp_about.html (last visited Apr. 12, 2013).

159. *See Law School Public Interest Programs—Loan Repayment Assistance Programs*, AM. BAR ASS'N, http://apps.americanbar.org/legalservices/probono/lawschools/pi_lrap.html (last updated June 29, 2012). In addition, some law schools administer loan deferral and forgiveness funds for students to pursue public interest work. *See, e.g.*, Hudson Sangree, *To Forgive is Divine*, NE. LAW MAGAZINE, Winter 2012, at 19–23 (describing special funds and assistance given to law graduates engaged in public interest law).

160. *The Armed Forces Offer Relief for Student Debt*, MILITARY.COM, http://www.military.com/Resources/ResourcesContent/0,13964,44245--,00.html (last visited Mar. 9, 2013)

161. Higher Education Technical Amendments Act of 1991, Public Law 102-26, codified at 20 U.S.C. § 1091a(a) (2012).

162. *See* N.J. Higher Educ. Student Assistance Auth. v. Colgan, 2010 WL 3075562, at *3 (N.J. Super. Ct. App. Div. Aug. 9, 2010) (deciding that the ten-year state statute of limitations applies to an action to collect a non-federal student loan).

163. *See Forgiveness, Cancellation, and Discharge*, U.S. DEP'T OF EDUC. http://studentaid.ed.gov/repay-loans/forgiveness-cancellation (last visited Apr. 12, 2013).

164. Karen Datko, *Bank Finally Forgives Dead Student's Loan*, MSN MONEY, May 1, 2012, http://money.msn.com/saving-money-tips/post.aspx?post=42205751-ea78-4308-8f3e-2707074e816d.

required to forgive the cosigner, and while some may do so, other lenders demand payment even if the student borrower has died.[165]

### *D. Debt and Desperation In The Indentured Generation*

#### *1. People You May Know*

There is no shortage of wrenching accounts from people struggling under mountains of student loan debt. There are any number of online sites where commentators and student debtors chronicle their experiences.[166] Undoubtedly the poster child for crushing student loan debt is a family practitioner in Columbus, Ohio, whose $250,000 in loans for medical school eventually mushroomed to $550,000 after deferments for her residency, missed payments with late fees, and compounding interest.[167] A more typical situation is that of a student who borrowed $79,000 in loans to study interior design at a for-profit college.[168] By graduation, her debt had grown to over $100,000. She could not find a job in her field and obtained several forbearances, incurring additional interest and fees. She eventually landed a job in a different field and after making timely payments for five years, she still owes $98,000. When her loans are paid off in twenty-five

165. *See id*. (private lender forgives cosigner of loan six years after student debtor's death after cosigner collects 75,000 signatures on an on-line petition); *see also*, Karen Datko, *Dad Overwhelmed by Dead Student's Loans*, MSN MONEY, June 15, 2012, http://money.msn.com/saving-money-tips/post.aspx?post=76403ee4-9604-480e-ad05-9f2cf2292cce (cosigner dad who earns $21,000 liable for student loans of $167,000 after son died in car crash).

166. *See* Lorin, *supra* note 2 (relating how a mother in the 1960s incurred $5000 in debt for her nursing degree, which she paid off within three years after graduation, while her 38-year old son incurred $85,000 in debt for a master's degree, cannot find work, and lives at home); *see also* Andrew Martin & Ander W. Lehren, *Degrees of Debt: A Generation Hobbled by the Soaring Cost of College*, N.Y. TIMES, May 12, 2012, http://www.nytimes.com/2012/05/13/business/student-loans-weighing-down-a-generation-with-heavy-debt.html?pagewanted=all (profiling a 2012 graduate of Ohio Northern University works two jobs to pay off $120,000 loan and lives at home with his parents).

167. Mary Pilon, *The $550,000 Student-Loan Burden*, WALL ST. J., Feb. 13, 2010, *available at* http://online.wsj.com/article/SB10001424052748703389004575033063806327030.html#printMode.

168. Sue Shellenbarger, *To Pay Off Loans, Grads Put Off Marriage, Children*, WALL ST. J., Apr. 17, 2012, *available at* http://online.wsj.com/article/SB10001424052702304818404577350030559887086.html.

years, she will have paid $211,000. She figures that for now she cannot afford to study for a business degree, start her own business, own a house, or have children.[169] Below are profiles of four student loan debtors who were interviewed for this Article.[170]

*i. Debtor 1*

Debtor 1 is in her mid-thirties and has dual degrees in music education and music therapy from a private nonprofit music school, which she attended over fourteen semesters from 2003 to 2008. With tuition costs of $10,000 per semester, living costs of $13,000 per year, and fees, insurance, instruments, a computer, and other items required by the school, she borrowed $202,600, including $138,500 in private loans and $64,000 in state and federal loans. Debtor 1 had no music training before she enrolled, and no audition was required. Admissions personnel assured her she could readily find contract work in music therapy at $60 per hour, but no such jobs have materialized. And, she cannot work in music education because she cannot afford to perform the four-months of unpaid internship plus purchase the six credits that state licensing would require. Unable to find work in her field after graduation, Debtor 1 is employed as a switchboard operator for a large company where she makes $29,800 per year. After taxes and modest living expenses, she has $124 per month for debt service. For years following graduation, she struggled to make loan payments and worked with her lenders to restructure payments. Finally, after going into default on her private loans and with judgments looming, she filed Chapter 13 bankruptcy in 2011. As of the petition date, with interest, the debt had mushroomed to $248,600. During her bankruptcy, she will not be making regular loan payments, so interest on the debt will continue to accumulate.

When asked about how she could have allowed so much debt to accumulate, Debtor 1 has several answers. First, coming from a blue-collar background, she knew essentially nothing about finances, making a living, and paying back

169. *Id.*

170. These accounts are from my correspondence with the debtors, and they remain in my possession.

debt. Higher education was perceived as the key to a meaningful career and lifetime earning potential. It did not occur to her to consider the amount of debt she was accumulating until she was several years into her program, and by then, with so much invested, it was unthinkable not to continue. Second, borrowing, especially from private sources, was absurdly easy. Two loan sources, Citibank and TERI, supplied all of her private loans, and it took only ten minutes online per semester to borrow anywhere from $10,000-$20,000. Neither loan source required her to provide her real signature. One lender required a parent to cosign each loan, but after obtaining an initial electronic signature from her father, the lender did nothing to verify that the parent had, in fact, agreed to cosign subsequent loans. It was only after Debtor 1 defaulted that her father, who had electronically co-signed one loan, learned about the other loans for which he was obligated. Tragically, her father has not communicated with her since that time.

Debtor 1 compartmentalizes the fact that she owes so much, and while she imagines that she will one day be out of debt, there seems to be no feasible way this will ever happen. In the meantime, she has friends, a pet, and a very modest social life. She does not own a home or a car, nor does she have credit cards. She does not expect her situation to change any time in the foreseeable future.

*ii. Debtor 2*

Debtor 2 is in her mid-thirties and has three children under the age of fifteen. Her annual income of $30,700 comes from social security disability, child support, and food stamps, and is well below the state minimum where she lives. Her rental payment of $550 a month is half the IRS average for a family of four in her area, and all her other allowable expenses (food, clothing, medical, utilities, etcetera) are at or below the IRS guidelines. Nevertheless, Debtor 2's allowed expenses of $2565 per month exceed her monthly income by $2. Additionally, two of her children have special medical conditions that require frequent hospitalization, and Debtor 2 must care for them around the clock.

Debtor 2 enrolled in a medical training program, but was unable to complete it because of parenting demands.

Unfortunately, she borrowed $17,200 in student loans when she was in the program. With expenses in excess of her social security income, Debtor 2 is unable to pay any of her debt. When she filed for bankruptcy, she also filed an adversary proceeding to have the student loan debt discharged. The creditor answered the complaint and started discovery, including a deposition and interrogatories and requests for production of documents. Among the information requested were documents regarding her medical condition and that of her children. Debtor 2 could not afford the cost to copy all the records, and through her lawyer, offered to provide authorization for the creditor to obtain its own copies. At the conclusion of her deposition, counsel for the creditor told Debtor 2's attorney that, as it appeared that she was disabled and unable to pay the debt, he would recommend that his client agree to the discharge, and therefore it was not necessary for Debtor 2 to provide any documents or even to proceed with administrative remedies such as income contingent repayment. However, the creditor later refused to agree to the discharge, in part because Debtor 2 had failed to provide documents to establish her medical condition. Ultimately, Debtor 2 entered into an income based repayment program. Based on her income, her payments are $0, so the result might seem the same as discharge of the debt. However, under IBR, Debtor 2 must provide extensive medical and financial information to prove her condition each year. For her, it would have been far easier and less stressful if the creditor had agreed to the discharge.

*iii. Debtor 3*

Debtor 3 is in her late forties and lives in a modest condominium in a Midwestern city. She received a BFA degree at a prestigious university in 1989, for which she incurred a loan for $11,000 from the Department of Education. In addition, she used credit cards to supplement college costs, and, as she says, "to have a bit of fun during the summers." Debtor 3's first job after college was working in a diner, but eventually she found work in electronic printing. Still, the salary was low and she did not make many payments on her loan. Financially strapped with student loans and credit card debt, Debtor 3 filed a pro se bankruptcy

in 1990. She received a discharge in 1991. Debtor 3 says that the standard discharge order was confusing, so she wrote to the judge to confirm that all claims on the list of creditors had been discharged. He returned a handwritten response at the bottom of her letter that said simply "your case was granted," which she took to mean in the debts had been discharged.

Following the bankruptcy, and assuming that her student loan debt had been discharged, and Debtor 3 made no further payments. She even got all references to the loan removed from her credit report, which to her confirmed that the debt was discharged. Nevertheless, student loan collectors continued to call and send collection letters. Sometimes Debtor 3 responded with snarky letters of her own, but she continued to assume that the debt had been discharged. However, in 1998, the Department of Education placed a levy on her tax return, and it has continued to do so ever since. A collection agency began pursuing her in earnest starting in 2006, eventually garnishing her wages. For a time, the Department of Education granted her requests for a hardship deferral, but after two years refused to allow any further deferment. Along the way, Debtor 3 studied for and received an MFA in the hopes that it would improve her career prospects. That resulted in an additional $5000 student loan owed to a private lender, but the new degree did not enhance her career prospects.

In recent years, Debtor 3 has taught part time and worked in a variety of temporary jobs, but has been unable to find permanent work. She earns sporadic income from work as a process server, selling art, and even as a subject for paid medical testing. Debtor 3 has also used credit cards to purchase basic necessities. When her unemployment benefits ran out in 2011, Debtor 3 filed a second pro se Chapter 7. By that time, her federal student loan debt had grown to $25,000, and she still owed $2000 in private student debt. She filed a pro se adversary proceeding against both lenders seeking discharge for undue hardship under the *Brunner* criteria.[171] The private lender did not respond, so the court granted a default judgment. This is not surprising, given

171. The case of Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987), sets forth a three-part test to establish undue hardship for discharge of student loan debt.

that the cost of retaining counsel and responding to the complaint would cost more than the amount owed. But the Department of Education did respond, and after a year of heated litigation in which Debtor 3 received occasional pro bono help from a bankruptcy attorney, the parties agreed to a settlement of $1000.

*iv. Debtor 4*

Debtor 4 is a recent law school graduate. Unlike the other debtors profiled above, he has not filed bankruptcy and does not anticipate doing so. But his story is typical of tens of thousands of recent law grads,[172] so it is worthwhile presenting it here. Debtor 4 had no undergraduate student debt and worked at a steady job in business making $50,000 per year for five years before starting law school. He was not dissatisfied with that income, but was bored and felt his upside prospects were limited, so he decided to attend law school. To pay for law school, Debtor 4 incurred between $189,000 and $191,000 in debt (he is not certain of the exact amount). He received two loans each year during law school: a Grad Plus loan of $40,000 per year that went directly to the law school, and a Stafford loan of $21,000 per year, which covered his living and other expenses. The amount of his debt is so large that it feels amorphous and almost unreal. He currently has a deferment, but Debtor 4 calculates that when it runs out his payments will be between $1200 to $1500 per month. Right now, however, he is just worried about paying rent and other basic expenses. Despite solid grades in law school, he works two temporary legal jobs netting $2000 per month. Debtor 4 will take a permanent position wherever he can get it. When asked if he is glad he went to law school, Debtor 4 says yes, but that he is "one of the few who is." Notwithstanding his financial worries, Debtor 4 enjoys legal studies and legal work, and is confident that his training and abilities portend a bright future.

172. *See, e.g.*, Caplan, *supra* note 42 (discussing high debt levels and doubtful employment prospects for current law graduates).

*2. The Logic and Illogic of College Education*

The debtors described above may have been imprudent in incurring their student loans, but each did so with the expectation that an education would enable them to earn a living. Investment in education is prudent if the borrower can utilize that education to make sufficient income to pay off the debt within a reasonable period. But this depends upon two assumptions. First, the amount of debt is proportionate to the income that can reasonably be expected in the career for which the student has trained. Second, there will be sufficient employment opportunities after graduation. Increasingly, these assumptions are not valid for many student borrowers.

The first assumption, that the amount of education debt is proportional to expected income, is undermined by the skyrocketing cost of education in recent years. Increases in tuition, fees, and other expenses of higher education have outstripped inflation in every other major sector of the economy, such as energy, food, healthcare, and even housing during the time when housing itself was experiencing a bubble.[173] The cost of tuition alone has ballooned from 23% of median annual earnings in 2001 to 38% in 2010.[174] To illustrate the difficulty of managing student loan debt, assume a four-year college graduate named Joan gets a job in Dallas with a salary of $41,701, which was the prototypical average salary for 2011 graduates.[175] Fortunately, Texas has no state income tax, so Joan's take home pay after federal taxes (but with no other deductions such as retirement, health insurance, etcetera) is $34,377.15 per year[176] or $2,864.75 per month. Average apartment rent outside the expensive Dallas City Center is $725 per month, but Joan is

173. Justin Pope, *Is Student Loan Education Bubble Next?*, BOSTON.COM, Nov. 6, 2011, http://articles.boston.com/2011-11-06/news/30367269_1_student-loan-federal-stafford-bubble.

174. *The College-Cost Calamity*, *supra* note 24.

175. *See Starting Salaries for New College Graduates*, NAT'LL ASS'N OF COLLS. & EMP'RS, 3 (2012), *available at* http://www.naceweb.org/uploadedFiles/NACEWeb/Research/Salary_Survey/Reports/SS_January_exsummary_4web.pdf.

176. *Texas Payroll Check Calculator*, PAYROLL GURU, http://www.payrolltexas.com/PayrollCheckCalculator.aspx (last visited Mar. 9, 2013).

frugal and takes the cheapest place she can find at $600 per month.[177] Using standard cost of living percentages, Joan will pay at least $3000 per month for housing, food, transportation and other expenses.[178] Ouch! Joan is already in trouble because her monthly living expenses exceed her monthly take home pay. Somehow she gets by for a while, but after six months her student loan repayment kicks in. If Joan has $27,000 in student loan debt (the national average for a four-year college graduate) and uses the standard repayment plan, she will have to pay $310.72 per month.[179] How will she get by and keep up with her student loan repayments? Joan is not sure, but somehow she will find a way. Fortunately, she has no dependents or medical expenses, and she will probably get a raise after her first year. But many borrowers do have dependents, medical expenses, insurance and payroll deductions, or will not get a raise. Some of them do not even have jobs.

Despite Joan's problems, the downside of not attending college may be worse. On average, a person with a bachelor's degree will earn one and a half times more over their lifetime than those with only a high school diploma.[180] Median weekly earnings in 2011 for a person with a bachelor's degree was $1053, compared to $768 for a person with an associate degree, and $638 for a person with only a high school diploma.[181] As of January 2012, the unemployment rate for

177. *See Cost of Living in Dallas, TX, United States*, NUMBEO, http://www.numbeo.com/cost-of-living/city_result.jsp?country=United+States&city=Dallas%2C+TX (last visited May 9, 2013).

178. *Id.*

179. This is calculated using the Department of Education online loan repayment calculator at *Income-Based Repayment Plan*, *supra* note 138.

180. JENNIFER CHEESEMAN DAY & ERIC C. NEWBERGER, THE BIG PAYOFF: EDUCATIONAL ATTAINMENT AND SYNTHETIC ESTIMATES OF WORK-LIFE EARNINGS, UNITED STATES CENSUS BUREAU 3 (2002), *available at* http://www.census.gov/prod/2002pubs/p23-210.pdf. Average weekly earnings for someone with less than high school diploma is $545, for a high school graduate is $626, and for someone with some college but no degree is $699. The average unemployment rate for people with only a high school degree or less education was 21.5% as of March 2013. U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, http://www.bls.gov/news.release/empsit.t04.htm; *see also*, Derek Thompson, *The Incredible Shrinking Work Force*, THE ATLANTIC, Dec. 8, 2011, http://www.theatlantic.com/business/archive/2011/12/the-incredible-shrinking-work-force/249688/.

181. STANDARDS & POOR'S, *supra* note 21, at 15.

people with a bachelor's degree or higher was approximately 4%, compared to 9% for people with a high school degree and no college.[182] So, students may feel they have no choice but to incur debt for post-secondary education.[183]

The second assumption, that graduates can find a job in the field for which they have studied, is also increasingly tenuous. It has long been true that post-graduate students working on a master's or doctoral degree in the humanities and social sciences take a significant risk that they will be unable to find jobs once they obtain their degrees (which can take seven to ten years of study and research). This is part of the culture of graduate education in these fields.

But there are increasingly fewer jobs for graduates in such formerly reliable areas as business, accounting, law, and education.[184] Does this mean that grad school is a bad bet? Not necessarily. The slowest job growth is among people with a four-year college degree, but nothing else.[185] For newer graduates aged twenty-four years or younger, the unemployment rate as of May 2012 was 7.6%,[186] just barely above that of high school graduates. For new graduates who do get jobs, starting out in tough economic times can often mean lower earnings over a lifetime since the average worker gets 70% of their pay raises during the first decade of employment.[187] That can translate into earning 10% less

182. *Id.* at 13.

183. "Paying for one's education . . . is a toll imposed on workers in exchange for the possibility, not even the certainty, of employment." George Caffentzis, *The Student Loan Abolition Movement in the United States*, *in Generation of Debt: The University in Default and the Undoing of Campus Life*, RECLAMATION J. 31, 39, Aug//Sept. 2011, *available at* http://libcom.org/library/generation-debt-university-default-undoing-campus-life.

184. *See, e.g.*, Blake Ellis, *Class of 2011 scores higher-paying jobs*, CNN MONEY, Jan. 12, 2012, http://money.cnn.com/2012/01/12/pf/college/salaries/index.htm (stating that engineering and computer science graduates have higher starting salaries); Steven Greenhouse, *Jobs Few, Grads Flock to Unpaid Internships,* N.Y. TIMES, May 5, 2012, http://www.nytimes.com/2012/05/06/business/unpaid-internships-dont-always-deliver.html?pagewanted=all (noting growth of unpaid internships as the only opportunity for new college grads).

185. Don Peck, *Can the Middle Class be Saved?*, THE ATLANTIC, http://www.theatlantic.com/magazine/print/2011/09/can-the-middle-class-be-saved/8600/ (last viewed Mar. 9, 2013).

186. STANDARD & POOR'S, *supra* note 21, at 14.

187. Daniel Gross, *The Economic Agony of Today's Twenty-Somethings*, YAHOO! FINANCE, Oct. 26, 2011, http://finance.yahoo.com/blogs/daniel-

than those starting their careers during good economic times.

The twin components of high education debt and limited career opportunities sentence tens of thousands of young adults to lifelong financial servitude. They will find themselves working for creditors from decades past and their personal choices will be highly constrained.

## II. BANKRUPTCY AND STUDENT LOAN DEBT

### *A. The Purpose and Procedures of Consumer Bankruptcy*

The purpose of consumer bankruptcy is to allow the honest but unfortunate debtor to receive a fresh start and to not be burdened for life with the financial consequences of misfortune or bad choices.[188] A debtor commences his bankruptcy by filing a bankruptcy petition,[189] schedules of assets, liabilities, income, expenses, and other information.[190] Once the debtor files a petition, any action to collect or enforce a debt against the debtor is stayed.[191] All of the debtor's assets become property of the estate,[192] thus subject to court control and potential distribution to creditors until the case is closed.

With only a few exceptions, consumer cases are filed under Chapter 7 or Chapter 13 of the Code. In Chapter 7 bankruptcy, a trustee is appointed to secure and sell the debtor's non-exempt assets[193] and to use the proceeds to pay claims of unsecured creditors on a pro rata basis.[194] Exemptions allow a consumer debtor to retain personal property up to a certain value, and so only non-exempt assets may be seized by the trustee.[195] The debtor's remaining unsecured debt is discharged.[196] If a debtor is current on his or her secured obligations, such as a mortgage or car

gross/economic-agony-today-twenty-somethings-143010262.html.

188. Grogan v. Garner, 498 U.S. 279, 287 (1991).
189. 11 U.S.C. § 301 (2012).
190. *Id.* § 521(a)(1)–(2).
191. *Id.* § 362(a).
192. *Id.* § 541(a).
193. *Id.* § 704.
194. *Id.* § 726(b).
195. *Id.* § 522(b)–(d).
196. *Id.* § 727.

payment, the debtor may retain the collateral[197] and continue making payments.[198] However, if the debtor is in default, the creditor may obtain relief from stay and pursue whatever remedies are allowed under state law, such as foreclosure or a levy and sheriff's sale.[199] Some debts, such as domestic support orders,[200] debt incurred by fraud,[201] and certain taxes[202] are not dischargeable. Although Chapter 7 is often referred to as liquidation, most debtors retain some or all of their property through exemptions.[203]

As with Chapter 7, a debtor commences a Chapter 13 bankruptcy by filing a petition, along with schedules of assets and liabilities. However, instead of receiving a prompt discharge, the debtor must submit a plan of reorganization under which she devotes all of her monthly projected disposable income to repay a percentage of unsecured debt over a period of five years.[204] The debtor makes a single monthly payment to the Chapter 13 trustee, and the trustee distributes the payment to creditors. Upon completion of the plan, any remaining unsecured debt is discharged.[205] The debtor must remain current on payments for secured collateral that debtor wants to retain.[206] A Chapter 13 trustee in each federal district oversees Chapter 13 cases in the district.[207] The primary duty of a Chapter 13 trustee is to receive monthly payments made by debtors,[208] and to distribute the proceeds to creditors as provided under the plan.[209] Some Chapter 13 trustees allow debtors to pay secured or long-term debts (debts with payments that extend beyond the duration of the plan) outside the plan.

197. *Id.* § 521(a)(2)(A).
198. *Id.* § 522(c)(1).
199. *See id.* § 362(d) (providing relief of stay).
200. *Id.* § 523(a)(5).
201. *Id.* § 523(a)(4).
202. *Id.* § 523(a)(1).
203. *See id.* § 522(b)(1)–(3) (listing which properties can be exempted from liquidation).
204. *Id.* §§ 1322(a)(4), 1325(b)(4)(a).
205. *Id.* § 1328(a).
206. *Id.* § 1322(b)(5).
207. *See id.* § 1302 (listing the duties of the trustee as appointed by the U.S. trustee).
208. *Id.* §§ 1302(b)(5), 1326(a)(2).
209. *Id.* § 1326(a)(2).

In 2004, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)[210] after decades of complaints by creditors that it was too easy for consumers to walk away from debt in bankruptcy.[211] BAPCPA's controversial centerpiece is a complex means testing formula used to determine whether the debtor may file a Chapter 7 or if she must seek relief under Chapter 13. If the debtor's gross income is above the forum state median, then the debtor will be presumed to have abused the bankruptcy process if she files a Chapter 7 bankruptcy.[212] For Chapter 13 debtors, a formula similar to means testing is used to determine the amount of the debtor's disposable income that must be paid each month to fund the Chapter 13 plan.[213] The test is done on Official Bankruptcy Form 22C, which requires the debtor to enter income and expenses according to certain statutory formulae and allowances. The resulting amount is the debtor's disposable income. For many debtors, the disposable income calculated on Form 22C is different from the debtor's actual income.

As noted, a debtor must file schedules of liabilities. Secured debt is listed on Schedule D. With certain exceptions, a security interest is not affected by bankruptcy, and secured creditors ultimately have recourse to their collateral. If the debtor intends to retain property subject to a security interest, the debtor generally continues paying the creditor as per the security agreement.

As provided in § 523 of the Code, certain types of unsecured debt are classified as priority unsecured debt and are not dischargeable in bankruptcy.[214] These include debts such as tax debt incurred in the two years immediately before filing, or tax debt for which returns were never filed,[215]

210. Pub. L. No. 109-8, 119 Stat. 23 (2005).

211. *See* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 488–89 (2005) (stating that early concerns about the bankruptcy system were that it was too easy to obtain discharge).

212. *See* 11 U.S.C. § 707(b)(1) (detailing when the court can dismiss a debtor's case).

213. *Id.* § 1325(b)(2)–(3).

214. *Id.* § 523.

215. *Id.* § 523(a)(1).

domestic support obligations,[216] and certain types of government fines and other penalties.[217] These debts are listed on Schedule E and must be paid in full before any non-priority unsecured claims may be paid.[218]

For a typical consumer debtor, the majority of their unsecured debt is dischargeable in bankruptcy. These types of debt are referred to as non-priority general unsecured debt, and are filed on Schedule F.[219] General unsecured debt is paid pro rata so that each creditor receives the same percentage of any distributions. There are certain types of debt that are listed on Schedule F as non-priority that are potentially nondischargeable, but only if the creditor objects to the discharge, and after a hearing and determination by the court.[220] These include certain types of fraud,[221] embezzlement,[222] larceny,[223] and willful injury to property.[224]

### *B. Student Loan Debt and Bankruptcy*

#### *1. Statutory: Bankruptcy Code Provisions*

The Bankruptcy Code took effect in 1978. Under its predecessor, the Bankruptcy Act,[225] student loans were not treated differently from any other dischargeable debt until the passage of the Education Amendments Act of 1976.[226] Section 439A of the Education Amendment Act prohibited discharge of student loans in bankruptcy for the first five years of loan repayment unless the debtor could establish undue hardship.[227] The 1978 Code continued the five-year bar against discharge of student debt. In 1990, the student

216. *Id.* § 523(a)(5).
217. *Id.* § 523(a)(7).
218. *Id.* § 726(a)(1)
219. Official Bankruptcy Form 6F.
220. *Id.* § 523(c)(1).
221. *Id.* § 523(a)(2), (4).
222. *Id.* § 523(a)(4).
223. *Id.*
224. *Id.* § 523(a)(6).
225. An Act to Establish a Uniform System of Bankruptcy Throughout the United States, Ch. 541, 30 Stat. 544 (1898 55th Congress), *amended by* Chandler Act of 1938, ch. 575, 52 Stat. 840 (repealed 1978).
226. Education Amendments Act of 1976, Pub. L. No. 94-482, 90 Stat. 2081, (codified at 20 U.S.C. § 1087-3 (1976)) (repealed 1978).
227. *Id.* § 439A.

loan discharge exception was extended to seven years.[228] In 1998, the Code was amended to provide that federally guaranteed student loans could not be discharged at all unless the debtor could prove undue hardship.[229] However, starting in 2005, under BAPCPA, the discharge exception was extended to include all education loans, including loans with no federal guaranty.[230]

At present, § 523(a)(8) of the Code provides that a Chapter 7 bankruptcy discharge does not discharge an individual debtor from any debt—

> (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—
>
> (A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or
>
> (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
>
> (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;[231]

In Chapter 13 bankruptcy, § 1328(a)(2) provides that a discharge does not discharge a debt "of the kind specified in . . . paragraph (8) . . . of section 523(a)."[232] Accordingly, education loan debt is not dischargeable in a Chapter 13 case without the same undue hardship showing as in a Chapter 7 case.[233] Cosigners and co-guarantors on a student loan are also subject to § 523(a)(8).[234]

Congress did not define undue hardship, so courts have had to determine what it means in this context. A threshold

228. *See* Student Loan Default Prevention Initiative Act of 1990, § 3006(b), Pub. L. No. 101-508, 104 Stat. 1388, 1388-28 to 1388-29.

229. *See* Higher Education Amendments Act of 1998, § 971, Pub. L. No. 105-244, 112 Stat. 1581, 1837 (1998).

230. 11 U.S.C. § 523(a)(8) (2012).

231. *Id.*

232. *Id.* § 1328(a)(2).

233. *See* United States Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1378 & n.10 (2010).

234. *In re* Pelkowski, 990 F.2d 737, 745 (3d Cir. 1993).

question is whether the debt in question is even subject to the rule. Section 523(a)(8) specifies four types of loans:

> (1) loans made, insured, or guaranteed by a governmental unit; (2) loans made or funded in whole or in part by a governmental unit or nonprofit institution; (3) loans received as an educational benefit, scholarship, or stipend; and (4) any qualified educational loan, as defined in the Internal Revenue Code.[235]

The lender has the initial burden of establishing the existence of the debt and that it falls within one of the four categories of nondischargeable debt.[236] Courts determine the educational nature of the loan based on the "substance of the transaction creating the obligation."[237] The substance of the transaction test looks to the stated purpose for which the individual obtained the loan, and not how the individual actually used the proceeds.[238] Thus, a court does not ask whether a computer purchased with loan money was used for schoolwork or personal use, but instead, "need only ask whether the lender's agreement with the borrower was predicated on the borrower being a student who needed financial support to get through school."[239]

Loans that are federally guaranteed such as Stafford Loans or Federal Direct Loans are clearly nondischargeable under § 523(a)(8)(A)(i), as are loans from state agencies and nonprofit organizations,[240] as well as educational benefit

235. *In re* Rumer, 469 B.R. 553, 561 (Bankr. M.D. Pa. 2012); *In re* Weldon, 2008 WL 4527654, at *2–3 (Bankr. W.D. Wash. Oct. 1, 2008).

236. Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon), 435 B.R. 791, 796 (B.A.P. 1st Cir. 2010) ("The creditor bears the initial burden of establishing that the debt is of the type excepted from discharge under § 523(a)(8)."); *see also In re* Rumer, 469 B.R. at 561. *But see In re* Carow, 2011 WL 802847 (Bankr. D. N.D. Mar. 2, 2011) ("Debtor failed to establish that the debt to Chase is not an obligation to repay funds received as an 'educational benefit.'"); *In re* Skipworth, 2010 WL 1417964, at *2 (Bankr. N.D. Ala April 1, 2010) (debtor failed to meet burden of proof that debt at issue was not a school loan).

237. *In re* Rumer, 469 B.R. at 562.

238. *In re* Sokolik, 635 F.3d 261, 266 (7th Cir. 2011); Murphy v. Penn. Higher Educ. Assistance Agency (*In re* Murphy), 282 F.3d 868, 870 (5th Cir. 2002).

239. *In re* Sokolik, 635 F.3d at 266; *see also*, *In re* Murphy, 282 F.d at 871 ("Section 523(a)(8) does not expressly state that only loans 'used for tuition' are nondischargeable. Nor does it define educational loans as excluding living or social expenses.").

240. *In re* Roberts, 149 B.R. 547 (Bankr. C.D. Ill. 1993) (loan made by nonprofit credit union is nondischargeable).

overpayments, such a Pell grant or GI benefits overpayment.[241] Obligations to repay an educational benefit, such as a grant to finance training in return for agreement to work in a designated sector upon graduation are also nondischargeable.[242]

Most private education loans are nondischargeable under § 523(a)(8)(B). Also nondischargeable are certain higher education loans as defined under § 221(d)(1) of the Internal Revenue Code (IRC). Section 221(d) allows the taxpayer to claim a deduction in interest paid on an education loan if the loan is a qualified education loan under IRC § 221(d)(1).[243] That section defines a qualified education loan as a loan incurred by the taxpayer "solely to pay qualified higher education expenses" which are incurred on behalf of the taxpayer, spouse or dependant for "education furnished during a period during which the recipient was an eligible student."[244] This in turn raises four additional definitions. First, the term qualified higher education expenses is defined as "the cost of attendance . . . at an eligible educational institution."[245] Second, an eligible student is a student, inter alia, "carrying at least 1/2 the normal full-time work load for the course of study the student is pursuing."[246] Third, an eligible educational institution is a post-secondary school authorized to participate in the U.S. Department of Education Student Loan program, which includes almost any post-secondary school, but would not include unaccredited schools or diploma mills.[247] Finally, cost of attendance

241. *In re* Coole, 202 B.R. 518, 519 (Bankr. D.N.M. 1996) (nondischargeable overpayment includes GI payments received by the student after leaving school).

242. *See In r*e Burks, 244 F.3d 1245, 1247 (11th Cir. 2001) (debtor must repay grant after failing to satisfy obligation of stipend to teach at "other race" school); Omaha Joint Elec. Apprenticeship Training Comm. v. Stephens (*In re* Stephens), 2011 WL 1395502, at *2 (Bankr. D. Neb. Apr. 12, 2011) (debtor owed education reimbursement to union when debtor took a job with non-union employer).

243. I.R.C. § 221(d)(1)(C) (2012).

244. *Id.* The term qualified education loan does not include any indebtedness owed to a person who is related to the taxpayer or recipient or under certain employer plans. *Id.*

245. *Id.* § 221(d)(2).

246. *Id.* §§ 221(d)(3), 25A(b)(3)(B).

247. *See id.* § 25A(f)(2).

Eligible educational institution—The term "eligible educational

includes tuition, fees, books, equipment, room and board, and miscellaneous personal expenses as determined by the specific school.[248]

Although the sweep of § 523(a)(8)(B) is broad, it is not infinite. For example, while § 523(a)(8)(A) covers all loans for education (including secondary school), § 523 (a)(8)(B) only excludes loans for higher education from discharge. And even then, the debt must be incurred "solely to pay qualified higher

institution" means an institution—

(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and

(B) which is eligible to participate in a program under title IV of such Act.

*Id.*

In addition, IRS publication 907, at 37, states that an eligible educational institution is:

> [A]ny college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

IRS Publication 970 (2012), *available at* www.irs.gov/publications /p970/ch09.html.

248. 20 U.S.C. § 1087*ll* defines cost of attendance as:

> (1) tuition and fees normally assessed a student carrying the same academic workload as determined by the institution, and including costs for rental or purchase of any equipment, materials, or supplies required of all students in the same course of study;
>
> (2) an allowance for books, supplies, transportation, and miscellaneous personal expenses, including a reasonable allowance for the documented rental or purchase of a personal computer, for a student attending the institution on at least a half-time basis, as determined by the institution;
>
> (3) an allowance (as determined by the institution) for room and board costs incurred by the student which—
>
> (A) shall be an allowance determined by the institution for a student without dependents residing at home with parents;
>
> (B) for students without dependents residing in institutionally owned or operated housing, shall be a standard allowance determined by the institution based on the amount normally assessed most of its residents for room and board;
>
> (C) for students who live in housing located on a military base or for which a basic allowance is provided under section 403(b) of title 37, shall be an allowance based on the expenses reasonably incurred by such students for board but not for room; and
>
> (D) for all other students shall be an allowance based on the expenses reasonably incurred by such students for room and board.

education expenses."[249] Mixed-use loans and credit card debt are generally not considered qualified education loans.[250] Nevertheless, it is the *purpose* and not the actual use of the funds that will govern if the loan is an education loan.[251]

As for refinancing and education loan consolidation, as provided under IRC § 221(d)(1), a qualified education loan includes "indebtedness used to refinance indebtedness which qualifies as a qualified education loan."[252] On the other hand, tuition and other education debts that were not incurred as loans are not covered by § 523(a)(8). Thus, debt owed to a university for unpaid tuition, board, or fees is dischargeable.[253]

### *2. Policy: Reasons for Nondischargeability of Student Loan Debt*

There may be several explanations for the policy of nondischargeability of student debt. One is that without the discharge exception, lenders would be unwilling to lend to students with little or no credit history. The discharge exception therefore makes it possible for lenders to provide funds for education without regard to the creditworthiness of the borrower. Indeed, student loan lenders may not refuse to lend to a prospective borrower on account of a prior bankruptcy.[254] In theory, this should democratize education by making school loans available to students of all socio-economic backgrounds. However, as 93% of new loans at the present time are federal loans,[255] student lending is more of a political venture than a financial one.

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20 U.S.C. § 1087*ll* (2006).

249. I.R.C. § 221(d)(1) (2012).

250. *See* 26 C.F.R. 1.221-1(e)(3)(i) (2012); 64 Fed. Reg. 3257, 3258 (1999).

251. *In re* Busson-Sokolik, 635 F.3d 261, 266 (7th Cir. 2011) (using the purpose driven test, the court will look to whether the lender agreement to make the loan "was predicated on the borrower being a student who needed financial support to get through school."); *In re* Murphy, 282 F.3d 868, 869–70 (5th Cir. 2002) (a student loan is nondischargeable even if part of the loan was used by the debtor to pay for a car and living expenses).

252. IRC § 221(d)(1); *see* United States v. DeKellis, 2010 WL 3521916 (E.D. Cal. Sept. 8, 2010) (a loan that consolidates a prior student loan remains nondischargeable).

253. *See In re* Chambers, 348 F.3d 650, 658 (7th Cir. 2003) (tuition and other unpaid charges are not considered a loan).

254. 11 U.S.C. § 525(c)(1) (2012).

255. CONSUMER FINANCIAL PROTECTION BUREAU, *supra* note 72.

A second argument is the need to ensure a pool of loan money for future students. This rests on the logic that if education loans are readily dischargeable in bankruptcy, then borrowers will have greater incentive to file for bankruptcy and more education loans will be discharged. This, in turn, will deplete federal and private funds available for new student loans.[256] So, the interest in ensuring the continued viability of the student loan program takes precedence.[257]

A third concern is that student borrowers will abuse student loan programs by filing bankruptcy after graduation, getting a discharge, and then enjoying a lifetime of income that education provides, but without the expense of paying back the loans.[258] Such conduct would be outright fraud if the student borrower planned to do so at the time he took out the loans. Or, it might be soft fraud if the student did not overtly plan to discharge the loans after graduation, but upon experiencing the difficulty of repaying, sought an easier way to deal with the debt than years of repayment.[259] However, there is no evidence of significant deliberate or soft fraud on the part of student loan borrowers.[260]

Finally is the theory that students themselves have taken on the debt burden and therefore should be responsible for repaying the debt. As one court stated:

> The government is not twisting the arms of potential students. The decision of whether or not to borrow for a college education lies with the individual; absent an expression to the contrary, the government does not guarantee the student's future financial success. If the

256. *See* William D. Henderson & Rachel M. Zahorsky, *The Law School Bubble: How Long Will It Last If Law Grads Can't Pay Bills?*, A.B.A. J. Jan. 2012, at 30–35; *see also* John A.E. Pottow, *The Nondischargeability of Student Loans in Personal Bankruptcy Proceedings: The Search for a Theory*, University of Michigan Law School, Public Law Working Paper No. 75, at 261 2007), *available at* http://ssrn.com/abstract=967379.

257. *See* TI Fed. Credit Union v. DelBonis, 72 F.3d 921, 937 (1st Cir. 1995).

258. For an example, see the comments of Rep. Allen E. Ertel: "At a time when political, business, and social morality are major issues, it is dangerous to enact a law that is almost specifically designed to encourage fraud." H.R. Rep. No. 95-595, at 536 (1977).

259. Pottow, *supra* note 256, at 252–55.

260. TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 15 (2000); Richard Fossey, *"The Certainty of Hopelessness:" Are Courts Too Harsh Toward Bankrupt Student Loan Debtors?* 26 J.L. & EDUC. 29, 34 (1997).

> leveraged investment of an education does not generate the return the borrower anticipated, the student, not the taxpayers, must accept the consequences of the decision to borrow.[261]

The last argument is that a debtor's misfortune should not be borne by creditors. However, this argument could be made with respect to any debt, and if applied consistently, would effectively end consumer bankruptcy.

### *3. Procedural: Procedures for Discharge of Student Loan Debt*

The Code and Rule set forth procedures for discharge of student loan debt. Education loan debt must be listed by the debtor on Schedule F along with other general unsecured debt.[262] In a Chapter 7 case, education loan claims receive the same distribution as general unsecured debt. However, while general unsecured debt is discharged, student loan debt is not. After the Chapter 7 case is closed, usually in four to six months, the debtor continues making payments to the creditor.[263] A typical Chapter 13 is quite different. Payments to general unsecured creditors can extend for up to five years. The debtor's monthly payment is distributed pro rata to unsecured creditors, so education loan creditors will typically receive some money under the plan. However, unless the plan provides for 100% payment to unsecured creditors (which seldom happens), the education loan creditor will not receive the full amount it is owed each month. As a result, principal and interest may continue to accrue during the Chapter 13 bankruptcy. At the end of the plan, while other unsecured debt is discharged, the student loan debt will have actually increased. Thus, debtors in Chapter 7 do much better in regards to student loan payments because they will not have been in default for three to five years.[264]

In order to obtain discharge of a student debt, the debtor must file an adversary proceeding in accordance with Federal

261. *In re* Roberson, 999 F.2d 1132, 1137 (7th Cir. 1993).

262. *See* 11 U.S.C. § 521(a)(1)(B)(i) (2012); FED. R. BANKR. P. 1007(a)(1) (2010).

263. Some debtors may continue payments while the Chapter 7 case is pending, but many lenders will not accept the payments because of concern for violating the automatic stay under § 362. *See* 11 U.S.C. § 362.

264. *In re* Mason, 456 B.R. 245, 248 (Bankr. N.D. Va. 2011).

Bankruptcy Rules 7001 to 7087. An adversary proceeding is litigation within the bankruptcy case. The debtor is required to serve a complaint and summons upon the lender,[265] and the lender must answer the complaint within thirty days.[266] The case then proceeds with pleadings, motions, and discovery similar to the Federal Rules of Civil Procedure. At trial, the bankruptcy court must find that payment of the debt would impose an undue hardship upon the debtor and/or dependants.[267] A Chapter 13 debtor may bring the adversary proceeding at any time during the case, and need not wait until all payments have been made.[268]

A nuance to student loan discharge litigation is whether an adversary complaint to discharge student loan debt may be brought after the court has entered the discharge order. Section 350(b) allows the court *sua sponte* or on motion of a party to reopen a case for cause, including to accord relief to the debtor.[269] The longer the case has been closed, the greater the burden on the moving party to demonstrate sufficient cause to reopen the case.[270] Generally, courts have not allowed debtors to reopen a case to seek discharge of student loan debt where the circumstances giving rise to undue hardship occurred after the case was closed.[271] For example, a debtor reopened her Chapter 7 case three years after date of the discharge in order to seek discharge of her student loans retroactive to the petition date.[272] Her inability to pay the loans arose from injuries sustained in an accident after entry

265. *See* FED. R. BANKR. P. 7004 (applying the Federal Rules of Civil Procedure relating to service).

266. FED. R. BANKR. P. 7012.

267. *In re* Espinosa, 130 S. Ct. 1367, 1374–75 (2010).

268. *In re* Cassim, 594 F.3d 432, 434 (6th Cir. 2010).

269. 11 U.S.C. § 350(b) (2012). Whether a case should be open is committed to the discretion of the court. Arleaux v. Arleaux, 210 B.R. 148, 149 (B.A.P. 8th Cir. 1997).

270. *In re* Jackson, 144 B.R. 853, 855 (Bankr. W.D. Ark. 1992) (finding a strong policy in support of bankruptcy laws is the assurance of prompt and effectual administration of the estate).

271. *See, e.g.*, *In re* Root, 318 B.R.. 851, 853 (Bankr. W.D. Mo. 2004) (denying motion to reopen case thirteen years after entry of discharge because the passage of time made it unreasonable to entertain the complaint); *In re* Kapsin, 265 B.R. 778, 781 (Bankr. N.D. Ohio 2001) (stating that allowing a debtor to reopen years later would create a "perpetual Chapter 7 case").

272. *In re* Zygarewicz, 423 B.R. 909, 912 (Bankr. E.D. Cal. 2010).

of the discharge order.[273] The court ruled that the circumstances must arise before entry of the original discharge order "[b]ecause the accident had no casual link to the misfortune prompting the debtor to seek bankruptcy relief in the first instance."[274]

However, in a recent case, a debtor who received a Chapter 7 discharge filed to reopen her case four years later in order to discharge student loan debt.[275] The creditor did not oppose the motion and the issue before the court was whether the debtor's post-discharge circumstances could be considered in making an undue hardship determination.[276] The court held that post-discharge circumstances were relevant because the test for undue hardship requires the court to predict the debtor's future circumstances.[277] The court reasoned that it makes no sense for a court to go back to the time before the case was closed to predict the debtor's future circumstances when it is has the present facts before it.[278]

The fact that the debtor must prosecute an adversary proceeding to discharge student debt discourages debtors from seeking discharge of their debt. By definition, debtors file bankruptcy because they do not have enough money to meet their expenses. Discharge litigation can cost thousands of dollars,[279] which few debtors can afford irrespective of the merits of their case.

*4. Substantive: Education Debt Discharge in the Courts*

Education debt may only be discharged upon a showing of undue hardship.[280] The term undue hardship is not defined in the Code. The inability to pay one's debts does not alone

273. *Id.*
274. *Id.* at 913.
275. *In re* Crawley, 460 B.R. 421, 427 (Bankr. E.D. Pa. 2011).
276. *Id.* at 434.
277. *Id.*
278. *Id.* at 435 (citing *In re* Walker, 427 B.R. 471, 483–84 (B.A.P. 6th Cir. 2010)); *accord In re* Sederland, 440 B.R. 168, 171 (B.A.P. 8th Cir. 2010). The court in *Crawley* noted that, had the creditor presented arguments against reopening the case, the case may have been decided differently. *Crawley*, 460 B.R. at 434.
279. My informal survey of bankruptcy lawyers suggests a range of $3500 to $15,000 or more.
280. 11 U.S.C. 523(a)(8).

establish undue hardship, otherwise almost all bankruptcy debtors would meet the standard.[281] Bankruptcy courts have devised different tests to determine whether a debtor's circumstances constitute undue hardship.

*i. The Brunner Three-Part Test*

The majority of courts have adopted the *Brunner* test to determine undue hardship. The test is from the Second Circuit case of *Brunner v. New York State Higher Education Services Corp.*[282] *Brunner* set forth a three-part test under which the debtor must prove:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor had made good faith efforts to repay the loan.[283]

The *Brunner* prongs are conjunctive, so that judgment must be entered against the debtor if he fails any one of the three requirements, even if any of the others are satisfied.[284] Most jurisdictions have adopted the *Brunner* test, including the Third,[285] Fourth,[286] Fifth,[287] Sixth,[288] Seventh,[289] Ninth,[290] Tenth,[291] and Eleventh Circuits.[292]

281. *In re* Frushour, 433 F.3d 393, 399 (4th Cir. 2005).
282. 831 F.2d 395 (2d Cir. 1987).
283. *Id.* at 396.
284. *In re* Fabrizio, 369 B.R. 238, 244 (Bankr. W.D. Pa. 2007).
285. *In re* Faish, 72 F.3d 298, 306 (3d. Cir. 1995).
286. *In re Frushour*, 433 F.3d at 399; United Student Educ. Res. Inst. (*In re* Ekenasi), 325 F.3d 541, 546 (4th Cir. 2003).
287. U.S. Dep't. of Educ. v. Gerhardt (*In re* Gerhardt), 348 F.3d 89, 91 (5th Cir. 2003).
288. Oyler v. Educ. Credit Mgmt. Corp. (*In re* Oyler), 397 F.3d 382, 385 (6th Cir. 2005).
289. *In re* Roberson, 999 F.2d 1132, 1135 (7th Cir. 1993).
290. United Student Aid Funds, Inc., v. Pena (*In re* Pena), 155 F.3d 1108, 1112 (9th Cir. 1998).
291. Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1309 (10th Cir. 2004).
292. Hemar Ins. Corp. v. Cox (*In re* Cox), 338 F.3d 1238, 1241 (11th Cir.).

a. *Brunner's* First Prong

The first prong of *Brunner* requires the debtor to prove that with his current income and expenses, he cannot maintain a "minimal standard of living" if forced to repay student loans.[293] One factor in this determination is whether the debtor is maximizing his income and minimizing expenses.[294] As part of maximizing income, the debtor must look for a job in any field, not just the one for which the debtor trained or prefers.[295] In considering whether the debtor has minimized expenses, courts look to whether the debtor is in self imposed hardship due to unnecessary expenses—i.e., the extent to which the debtor's inability to pay creditors is caused by the debtor's own spending on extraneous expenses.[296] Luxury spending or unreasonable amounts spent on otherwise reasonable expenses (including food) may show that the debtor is able to maintain a minimal standard of living even with loan payments.[297] The relevant date for determining the minimal-standard-of-living element is the date of trial.[298]

The Bankruptcy Code does not define what constitutes a minimal standard of living. An oft-cited opinion, *In re Ivory*,[299] defines it as follows: (1) shelter (including heating and cooling); (2) basic utilities such as electricity, water, natural gas, and telephones; (3) food and personal hygiene products; (4) vehicles, along with insurance, gas, licenses, and maintenance; (5) health insurance or money to pay for

293. *See* Nixon v. Key Educ. Resources (*In re* Nixon), 453 B.R. 311, 315 (Bankr. S.D. Ohio 2011).

294. *Id.* at 327–28.

295. Tirch v. Penn. Higher Educ. Assistance Agency (*In re* Tirch), 409 F.3d 677, 681 (6th Cir. 2005) ("Tirch should have sought employment in another field when the stress of clinical social work became debilitating."); *In re* Healey, 161 B.R. 389, 395 (Bankr. E.D. Mich. 1993) (a debtor cannot ignore reasonable options in other fields in order to work in one's "field of dreams").

296. Educational Credit Management Corp. v. DeGroot, 339 B.R. 201, 208 (Bankr. D. Ore. 2006). The court also found that as the debtor had a three-bedroom house and no dependents, she should have taken on a roommate to share expenses. *Id.* at 210.

297. Mandala v. Educ. Credit Mgmt. Corp. (*In re* Mandala), 310 B.R. 213, 221–22 (Bankr. D. Kan. 2004) (holding that debtors could maintain minimal standard of living if they adjusted expenses, including food expenses).

298. *In re Nixon*, 453 B.R. at 326.

299. Ivory v. United States (*In re* Ivory), 269 B.R. 890 (Bankr. N.D. Ala. 2001).

healthcare; (6) some amount of entertainment or diversion, even if only a television or a pet.[300] Even though many courts consider the list set forth in *Ivory*, courts need not apply it mechanically:

> Rather, in appropriate circumstances, the court must be prepared to depart from the list based on its own experiences, common sense, knowledge of the surrounding area and culture, and assessment of the reasonableness of what debtor claims he or she needs. In addition, what is minimal can and probably should change over time (e.g., with new technology driving down the cost of things that might have previously been cost prohibitive).[301]

Although minimal standard of living is not supposed to mean that the debtor live in poverty, "it does mean that the debtor is expected to do some financial belt tightening and forgo amenities to which he may have become accustomed."[302] But standards can change with time. In recent years, courts have found that standard expenses for cell phones, cable, and Internet are basic and reasonable expenses.[303]

b. *Brunner's* Second Prong

To meet the second prong of *Brunner*, the debtor must present additional circumstances that show the debtor's state of affairs is likely to persist for a significant portion of the repayment period.[304] In essence, the debtor must demonstrate that "circumstances indicate a certainty of hopelessness, not merely a present inability to fulfill financial commitment."[305] This has been described as "the heart of the *Brunner* test and is often difficult to prove because it requires the debtor to prove that she will be unable to repay her student loan debt in the future for reasons outside her

300. *Id*. at 899.

301. Miller v. Sallie Mae, Inc. (*In re* Miller), 409 B.R. 299, 312 (Bankr. E.D. Pa. 2009).

302. Campton v. U.S. Dep't. of Educ. (*In re* Campton), 405 B.R. 887, 891 (Bankr. N.D. Ohio 2009).

303. *See e.g.*, *In re Nixon*, 354 B.R. at 329 (holding that telecommunications expenses are reasonable to permit debtors to have a source of entertainment, apply for employment online, and to communicate).

304. *See* Barrett v. Educ. Credit Mgmt. Corp. (*In re* Barrett), 487 F.3d 353, 359 (6th Cir. 2007).

305. *Id.* (citing Oyler v. Educ. Credit Mgmt. Corp, 387 F.3d 382, 386 (6th Cir. 2005).

control."[306]

In order to establish the requisite additional circumstances, the debtor may endeavor to show a variety of causes, such as illness, disability, lack of job skills, or a large number of dependants. The most common type of additional circumstance supporting undue hardship discharge appears to be medical-related issues, such as chronic mental or physical ailments that interfere with the debtor's ability to work and generate income.[307] Depression caused by debt, without more, generally does not suffice.[308] Ultimately, however, "the most important factor in satisfying the second prong is that the 'additional circumstances' must be 'beyond the debtor's control, not borne of free choice.'"[309] A debtor's decision to become poor or to remain poor after bankruptcy while better earning options are available indicates that the debtor's circumstances are a result of his own decisions.[310] A debtor who left a well-paying nursing career at age forty-five to enter chiropractic school could not complain that, at age fifty-four, the profession did not provide enough income for her to repay her student loan debts within her lifetime.[311] In another case, a debtor, an adjunct professor, refused to apply for permanent work at other schools because she deemed them too far from her home, even though the increased

306. *In re* Matthews-Hamad, 377 B.R. 415, 422–23 (Bankr. M.D. Fla. 2007) (internal citations omitted).

307. Rafael I. Pardo & Michelle R. Lacey, *The Real Student-Loan Debt Scandal: Undue Hardship Discharge Litigation*, 83 AM. BANKR. L.J. 179, 205 (2009). Cases confirming this include *In re* Todd, 473 B.R. 676, 680, 682, 695 (Bankr. Md. 2012) (loans discharged for sixty-three-year-old debtor with lifetime Asperger's syndrome, osteoporosis, and post-traumatic stress disorder resulting from subdural hematoma); *In re* Larson, 426 B.R. 782, 787 (Bankr. N.D. Ill. 2010) (debtor suffered from diabetes, total blindness caused by diabetes, medication for diabetes, treatment for heart condition that required quadruple bypass, and medication for kidney failure that required kidney transplant); *In re* Barrett, 487 F.3d 353, 361 (6th Cir. 2007) (debtor diagnosed with avascular necrosis and stage IV Hodgkin's lymphoma requiring multiple future surgeries).

308. Katheryn E. Hancock, *A Certainty of Hopelessness: Debt, Depression, and the Discharge of Student Loans Under the Bankruptcy Code*, 33 L. & PSYCHOL. REV. 151, 162 (2009) (analyzing mental health as a factor in student loan debt discharge cases).

309. *In re Barrett*, 487 F.3d at 359 (citing Oyler v. Educ. Credit Mgmt. Corp, 397 F.3d 382, 386 (6th Cir. 2005)).

310. *In re* Bene, 474 B.R. 56 (Bankr. W.D.N.Y., 2012).

311. *In re* DeRose, 316 B.R. 606 (Bankr. W.D.N.Y. 2004)

income would more than offset extra transportation costs.[312]

But not all choices are necessarily *free* choice. Where a debtor discontinued her studies twenty-five years previous in order to care for her infirm parents, the court characterized her decision as a *moral* choice, not a choice to be poor:

> [t]he *Brunner* test looks to the present and future, not to the distant past. The test requires that the court determine whether present circumstances will continue for a time into the future for reasons outside a debtor's control. A moral choice that some debtor made 24 or more years ago to forego opportunities she then had to improve herself, and thus to optimize her potential to earn enough money to repay her student loan debt, is not relevant to a *Brunner* analysis.[313]

In another case, a debtor incurred $200,000 of student loan debt for undergraduate and medical school, but by the time of her bankruptcy petition, had became a full-time stay at home mother with five young children, including two special needs children.[314] The debtor met the second prong of *Brunner*. As the court stated, "[t]his is not a case in which a debtor willfully chose to avoid payments that could have been made or was underemployed or unemployed for no discernible reason. Caring for her five young children has become Walker's full-time occupation."[315]

The distinguishing element in these cases is whether the debtor had options that could increase income or decrease expenses.[316] Changing patterns of income to care for elderly parents or raise children were found to not constitute free choice, whereas personal career changes or preferences were. In addition, the time frame of the choice, i.e., a recent choice

312. *In re* Gipson, 2012 Bankr. LEXIS 2745, at *7–9 (Bankr. D.Md. 2012). The debtor also refused to reactivate her law license to seek work in law, which would provide more income, for the reason that "I'm not interested in being an attorney. I do not consider myself an attorney. I am an educator." *Id.* at *11. *See* Nixon v. Key Educ. Resources (*In re* Nixon), 453 B.R. 311, 327–28 (S.D. Ohio 2011) (holding that debtor could not satisfy the second prong of *Brunner* without looking for all possible teaching positions).

313. *In re Bene*, 474 B.R. at 61.

314. Walker v. Sallie Mae (*In re* Walker), 650 F.3d 1227 (8th Cir. 2011).

315. *See id.* at 1234.

316. *See In re Bene*, 474 B.R. at 70 (noting that moral choices made a long time ago are different from lifestyle options that the debtor can feasibly modify after bankruptcy).

of the debtor or one in the distant past, can also be a consideration.[317]

Less frequently, the *Brunner* second prong can also be met where a debtor has been unable to find employment despite sustained and diligent efforts. The standard is strict. In one case, a pro se debtor had trained as a paralegal, but for ten years had sought unsuccessfully to land any type of a job.[318] The court, having observed the debtor's demeanor, body language, and overall attitude at trial, could not help but be moved: "[s]he has clearly been worn down by the difficulties she has experienced in her life, and it shows."[319] The court then noted the exceptional circumstances in which a debtor's history of failure to secure employment might justify a finding that the debtor met the second prong of *Brunner*:

> Rarely has the Court seen the kind of persistent job search efforts in which this DEBTOR has engaged over the past decade. Never has the Court seen such utter futility be the result of a debtor's job search efforts. This DEBTOR is truly destitute and has been in these straits for many years without any respite. . . . If the term "certainty of hopelessness" is to ever have any application, it is in this case.[320]

It is unclear the extent to which a debtor's advanced age may constitute an additional circumstance to satisfy the second prong of *Brunner*. In *Brunner*, the court held that no additional circumstances exist where the debtor "is not disabled *nor elderly*."[321] One court cited the debtor's age (early fifties) as limiting her earning capacity and thus her

317. *Id. at* 70. In *Bene*, the debtor, who was 64, had worked on an assembly line for 12 years, but with the plant closing and no other skills or degree, the court found that the debtor "[had no choice], and has not had such a choice for a very long time." *Id.* at 70.

318. Krieger v. Educ. Credit Mgmt. Corp. (*In re* Krieger), 2012 WL 1155687, at *5 (Bankr. C.D. Ill. 2012), *aff'd,* __ F. 3 __ 2013 WL 1442305 (C.A. 7 (Ill.) April 10, 2013) ("The [*Brunner* second prong] determination is based on the Court's judgment about whether and where this particular debtor is likely to work in the future and what she is likely to earn in the future.").

319. *Id.* at *6.

320. *Id.* at *6.

321. Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 365, 396 (2d Cir. 1987) (emphasis added).

ability to afford loan repayment.[322] However, other courts have held that people who take on education debt at an older age do not suffer undue hardship because they owe debt into their retirement age,[323] even if the debtor asserts he will be unable to pay the loan in their lifetime.[324]

c. *Brunner's* Third Prong

The third prong of *Brunner* is whether the debtor has made good faith efforts to repay the loan. As a starting point, failure by the debtor to make a payment does not of itself establish a lack of good faith.[325] Rather, courts measure a debtor's good faith by his "efforts to obtain employment, maximize income, and minimize expenses."[326] So, where a debtor attempted unsuccessfully to find work while living with his mother, and while at the same time suffering from debilitating medical conditions, the third prong of *Brunner* was satisfied.[327] On the other hand, a debtor's failure to make *any* payments when earning an income can be evidence of lack of good faith efforts.[328]

Some courts consider whether the debtor has participated in alternative repayment options.[329] Creditors may argue that this means the debtor must have negotiated a repayment

322. Hinckle v. Wheaton Coll. (*In re* Hinckle), 200 B.R. 690, 694 (Bankr. W.D. Wash. 1996).

323. *See, e.g.*, Educ. Credit Mgmt. Corp. v. Degroot, 339 B.R. 201, 212 (Bankr. D. Or. 2006) ("[W]here debtors choose to incur educational debt later in life, the fact that they will reach retirement age during the loan repayment period is not enough alone to justify discharge . . . ."); Mandala v. Educ. Credit Mgmt. Corp. (*In re* Mandala), 310 B.R. 213, 222 (Bankr. D. Kan. 2004) (where the debtor chose to return to school late in life on borrowed money, "[t]hat student loan payment may progress beyond a borrower's retirement age, standing alone, should not skew the second *Brunner* test against lenders.").

324. Fabrizio v. U.S. Dep't of Educ. Borrower Servs. (*In re* Fabrizio), 369 B.R. 238, 245–46 (Bankr. W.D. Pa. 2007) ("Debtor's personal belief as to the effect of payment is totally irrelevant on this issue.").

325. Educ. Credit Mgmt. Corp. v. Polleys, 356 F.3d 1302, 1311 (10th Cir. 2004) (holding that the debtor's "failure to make a payment, standing alone, does not establish a lack of good faith.").

326. Educ. Credit Mgmt. Corp. v. Mosley (*In re* Mosley), 494 F.3d 1320, 1327 (11th Cir. 2007).

327. *In re Mosley*, 494 F.3d at 1327.

328. *In re Fabrizio*, 369 B.R. at 245 (finding lack of good faith where debtor who made $37,000 per year failed to make any payments for two years).

329. Hertzel v. Educ. Credit Mgmt. Corp. (*In re* Hertzel), 329 B.R. 221, 233–34 (B.A.P. 6th Cir. 2005).

plan under the Income Contingent Repayment Program. However, in *In re Mosley*, the Eleventh Circuit rejected a per se test.[330] In that case, although the debtor's payment under an income contingent repayment plan would be zero, interest on the debt would continue to accrue and the amount forgiven at the end of twenty-five years could be treated as taxable income.[331] As the court pointed out, this is not always a viable option for debtors because it would require them to "trade one nondischargeable debt for another."[332]

The Sixth Circuit has also refused to hold that the good faith prong of *Brunner* requires the debtor to participate in income contingent repayment, noting that, inter alia, such a rule would in effect eliminate the discharge of student loans for undue hardship from the Bankruptcy Code.[333] The majority of courts agree.[334]

Overall, the difficulty in meeting the *Brunner* standard is exemplified by the case of *In re Fields*, in which a debtor filed a pro se adversary proceeding to discharge $115,000 of student loan debt.[335] He had been diagnosed as paranoid schizophrenic and adjudicated disabled by the Social Security Administration.[336] The debtor's monthly social security income was just barely above the poverty income threshold, and he had held a string of short-term jobs for ten years, unable to stay in any position for long because of his

330. *In re Mosley*, 494 F.3d at 1327.

331. *Id*.

332. *Id*. (quoting *In re* Barrett, 487 F.3d 353, 364 (6th Cir. 2007); *see also* Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon), 435 B.R. 791, 802 (B.A.P. 1st Cir. 2010) ("[T]he [income contingent repayment program] might be beneficial for a borrower whose inability to pay is temporary and whose financial situation is expected to improve significantly in the future. Where no significant improvement is anticipated, however, such programs may be detrimental to the borrower's long-term financial health." (citations omitted)).

333. *In re Barrett*, 487 F.3d at 364.

334. *See, e.g.*, *In re Bronsdon*, 435 B.R. 791; *In re* Benjumen, 408 B.R. 9 (Bankr. E.D.N.Y. 2009); *In re* Bene, 474 B.R. 56, 58 (Bankr. W.D.N.Y. 2012) (holding that requiring income contingent repayment would effect a repeal of § 523(a)(8)); Cagle v. Educ. Credit Mgmt. Corp. (*In re* Cagle), 462 B.R. 829 (Bankr. D. Kan. 2011); *In re* Crawley, 460 B.R. 421 (Bankr. E.D. Pa. 2011); Allen v. Am. Educ. Servs. (*In re* Allen), 324 B.R. 278, 281 (Bankr. W.D. Pa. 2005) (whether debtor has participated in deferment or restructuring program "is but one of the factors for the court to consider").

335. Fields v. Educ. Credit. Mgmt. Corp. (*In re* Fields), 2012 Bankr. LEXIS 1280, at *7 (Bankr. N.D. Ala. 2012).

336. *Id.* at *2–3.

disorder.[337] And, despite his willingness to work at any type of job, not just the legal field for which he had trained, his efforts to obtain employment were unsuccessful after three years.[338] This was sufficient evidence to establish undue hardship under the *Brunner* test.[339]

*ii. Totality of the Circumstances Test*

While *Brunner* is the majority rule, not all circuits have adopted the test. The Eighth Circuit uses a totality of the circumstances test under which the court considers "(1) the debtor's past, present, and reasonably reliable future financial resources; (2) a calculation of the reasonable living expenses of the debtor, and her dependants; and (3) any other relevant facts and circumstances surrounding each particular bankruptcy case."[340] Thus, the court found undue hardship where the debtor cared for five children, including two autistic children, and her spouse's income as a police officer was insufficient to meet their reasonable expenses, much less pay anything towards her $300,000 student loan debt.[341]

The First Circuit has not adopted a specific test, but instead focuses on the debtor's ability to earn an income in the future: "We see no need in this case to pronounce our views of a preferred method of identifying a case of 'undue hardship.' The standards urged on us by the parties both require the debtor to demonstrate that her disability will prevent her from working for the foreseeable future."[342]

In absence of specific instructions from the First Circuit Court of Appeals, the First Circuit BAP and bankruptcy courts in Massachusetts employ a totality of the circumstances test.[343] Courts adopting this approach find that the second and third prongs of *Brunner* go beyond what

337. *Id.* at *12–14, *19.

338. *Id.* at *23.

339. *Id.* at *28–29.

340. Walker v. Sallie Mae Serv. Corp. (*In re* Walker), 650 F.3d 1227, 1230 (8th Cir. 2011); Long v. Educ. Credit Mgmt. Corp. (*In re* Long), 322 F.3d 549, 554 (8th Cir. 2003).

341. *In re Walker*, 650 F.3d at 1234–35.

342. Nash v. Connecticut Student Loan Found. (*In re* Nash), 446 F.3d 188, 190–91 (1st Cir. 2006).

343. *See, e.g.*, Bronsdon v. Educ. Credit Mgmt. Corp. (*In re* Bronsdon), 435 B.R. 791 (B.A.P. 1st Cir. 2010).

is required under § 523(a)(8). In *Bronsdon v. Education. Credit Management Corp.* (*In re Bronsdon*),[344] the First Circuit BAP rejected the second prong of *Brunner*, which requires a showing that the debtor's state of affairs is likely to persist for a significant portion of the repayment period:

> Many courts interpreting and applying the second *Brunner* prong, however, place dispositive weight on the debtor's ability to demonstrate "additional extraordinary circumstances" that establish a "certainty of hopelessness." This has led some courts to require that the debtor show the existence of "unique" or "extraordinary" circumstances, such as the debtor's advanced age, illness or disability, psychiatric problems, lack of usable job skills, large number of dependents or severely limited education. . . . And, in the absence of such a showing, the court may conclude that the debtor has failed the second *Brunner* prong and the student loans will not be discharged. . . . Requiring the debtor to present additional evidence of a "unique" or "extraordinary" circumstances amounting to a "certainty of hopelessness" is not supported by the text of § 523(a)(8). The debtor need only demonstrate "undue hardship."[345]

The BAP also took issue with the third prong of *Brunner*, which requires the debtor to affirmatively prove good faith in attempting to repay the loan:

> [U]ltimately, the debtor must establish by a preponderance of the evidence that her present and future actual circumstances would impose an undue hardship if her debts are excepted from discharge. . . . The party opposing the discharge of a student loan has the burden of presenting evidence of any disqualifying factor, such as bad faith. The debtor is not required under the statute to establish prepetition good faith in absence of a challenge. The debtor should not be obligated to prove a negative, that is, that he did not act in bad faith, and, consequently, in good faith.[346]

The *Bronsdon* court found that debtor's efforts to repay a loan is just one of the elements in the totality of the

344. *Id.* at 802.

345. *Id.* at 800, (citing Hicks v. Educ. Credit Mgmt. Corp. (*In re* Hicks), 331 B.R. 18, 27–28 (Bankr. D. Mass. 2005)).

346. *Id.*

circumstances test, and not a dispositive requirement on its own. For example, income contingent or IBR programs allow for suspension or reduction of payments, but can result in the continued accrual of interest. Such "negative amortization" in fact increases the debtor's ultimate debt burden.[347] In addition, federal loan forgiveness effectively trades nondischargeable loan debt for nondischargeable tax debt.[348] Accordingly, many loan repayment programs may not be suitable for debtors, and the court should not consider them when determining whether the debtor should be allowed a discharge.[349]

*iii. Partial Discharge of Education Debt*

Some courts permit a debtor to discharge part of an education debt using *Brunner* or the totality of the circumstances criteria. Whether this is allowed under the Code may be unclear. On its face, § 523(a)(8) refers to discharge of "an educational benefit overpayment or loan ."[350] This can be construed to mean discharge of a loan in its entirety, and not a discharge of a part of a loan. Other provisions of the Code expressly provide for adjustment of a portion of a debt. For example, § 506(a)(1) allows for partial modification (bifurcation) of a secured debt into secured and unsecured components "to the extent of the value of such creditor's interest in [the collateral]."[351] In consumer cases, the debtor may avoid a judgment lien against property of the debtor "to the extent that such lien impairs an exemption to which the debtor would have been entitled."[352] In these provisions, the words *to the extent* show that partial treatment of the claim is allowed. There is no such language with respect to treatment of education debt.

In absence of express language allowing for partial discharge of education debt, some courts grant partial discharge pursuant to § 105.[353] That section provides that

347. *Id.* at 802.
348. *Id.* at 802–03.
349. *Id.*
350. 11 U.S.C. § 523(a)(8) (2012).
351. *Id.* § 506(a)(1).
352. *Id.* § 522(f)(1)(A).
353. *Id.* § 105(a).

"[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[354] Thus, courts have granted partial discharge of student loan debt by discharging part of the principal, accrued interest, or attorney's fees,[355] instituting a repayment schedule, deferring repayment, or even by allowing a debtor to reopen bankruptcy proceedings to revisit the question of undue hardship.[356]

The Sixth Circuit has held that partial discharge is permitted under § 105(a)[357] using the three-part *Brunner* criteria.[358] To receive the discharge, the debtor must satisfy each prong of the *Brunner* test with respect to the portion of the debt to be discharged, and the discharge is allocated pro rata among the debtor's loans.[359] In one case, a bankruptcy court applied the three-part *Brunner* test in discharging all but $8045.02 of the debtor's total student loan debt of $36,284.81.[360] "The debtor's inability to repay the student loans must result from factors beyond the debtor's reasonable control . . . ."[361] The court found that the most important element causing the debtor's financial problem was her cancer, and that because of this, "it is highly likely that [the debtor's] financial predicament will persist for many years, and possibly the rest of her life."[362]

354. *Id.*

355. Griffin v. Eduserv (*In re* Griffin), 197 B.R. 144, 147 (Bankr. E.D. Okla. 1996) ("[I]t would be an 'undue hardship' for the Debtors to pay any of the accrued interest and attorneys' fees associated with . . . student loans.").

356. *See supra* Part II.B.4.

357. Tenn. Student Assistance v. Hornsby (*In re* Hornsby), 144 F.3d 433, 440 (6th Cir. 1998); *see also*, Miller v. Pa. Higher Assistance Agency (*In re* Miller), 377 F.3d 616, 620 (6th Cir. 2004) ("[W]hen a debtor does not make a showing of undue hardship with respect to the entirety of her student loans, a bankruptcy court may—pursuant to its § 105(a) powers—contemplate granting . . . a partial discharge of the debtor's student loans.").

358. *In re* Oyler, 397 F.3d 382, 385 (6th Cir. 2005); *In re* Nixon, 453 B.R. 311, 336 (Bankr. S.D. Ohio 2011) (stating that a court may grant partial discharge of student loan debt).

359. *In re Nixon*, 453 B.R. at 336 (debtor with education debt of more than $270,000 may discharge any amounts in excess of $214,200, based upon *Brunner* criteria).

360. Jorgensen v. Educ. Credit Mgmt.. Corp., 2012 Bankr. LEXIS 254, at *17 (Bankr. D. Haw, 2012).

361. *Id.* at *14.

362. *Id.* at *13.

Courts in the Tenth Circuit,[363] Eleventh Circuit,[364] and lower courts in the Ninth Circuit[365] also grant partial discharge of student loans using the *Brunner* criteria. Other courts have ordered partial discharge under the totality of the circumstances test. For example, a Massachusetts bankruptcy court held that although the debtor had not proven undue hardship at trial, her long-term income prospects were dubious given her advanced age and history of poor health.[366] Therefore, the court held that if the debtor participated in the Ford Program and abided by the income-based option, the court would discharge whatever portion of the debt remained at the expiration of the repayment program.[367]

A hybrid approach was taken by the court in *In re Hinkle*.[368] In that case, the court ruled that there was no authority under the Code to a grant partial discharge of any education debt, but that where a debtor had multiple debts, the court could grant a full discharge to some of the debts while leaving the others nondischargeable, based upon the *Brunner* criteria.[369] Thus, of the debtor's six student loans, the court found that the three loans that had been in repayment the longest time, totaling $18,143, were dischargeable, but that the debtor would be able to pay the three remaining loans totaling $10,014.[370] Other courts use a

363. *See* Alderete v. Educ. Credit Mgmt. Corp. (*In re* Alderete), 412 F.3d 1200 (10th Cir. 2005).

364. *See* Hemar Ins. Corp. v. Cox (*In re* Cox), 338 F.3d 1238, 1243 (11th Cir. 2003) ("Because the specific language of § 523(a)(8) does not allow for relief to a debtor who has failed to show 'undue hardship,' the statute cannot be overruled by the general principals of equity contained in § 105(a).").

365. *See* Saxman v. Educ. Mgmt. Corp. (*In re* Saxman), 325 F.3d 1168, 1173 (9th Cir. 2003) ("[B]ankruptcy courts may exercise their equitable authority under 11 U.S.C. § 105(a) to partially discharge student loans."); Educ. Credit Mgmt. Corp. v. Jorgensen, 2012 Bankr. LEXIS 4303 (B.A.P. 9th Cir. Sept. 11, 2012) (partial undue hardship discharge of student loan debt affirmed as challenged expenses were justified by debtor's medical condition).

366. Stevenson v. Educ. Credit Mgmt. Program (*In re* Stevenson), 463 B.R. 586 (Bankr. D. Mass. 2011).

367. *Id.* at 599.

368. Hinkle v. Wheaton Coll. (*In re* Hinkle), 200 B.R. 690, 693 (Bankr. W.D. Wash. 1996).

369. *Id.* at 693.

370. *Id.* at 694; *see also* Gharavi v. U.S. Dep't. of Educ. & Educ. Mgmt. Corp. (*In re* Gharavi), 335 B.R. 492, 501 (Bankr. D. Mass. 2006) (debtor who suffered from fatigue due to MS established undue hardship in showing that she only

similar loan-by-loan approach.[371]

One problem with the loan-by-loan approach is that it requires a court to decide which loan(s) will be paid and which ones discharged. There is nothing in the Bankruptcy Code that addresses this type of prioritization, and several courts have held that loan-by-loan discharge is inappropriate for this reason.[372]

A number of courts have held that the Bankruptcy Code does not allow for partial discharge. These include the Third Circuit[373] and many bankruptcy courts.[374] Some commentators have criticized the use of § 105(a) to grant partial discharge.[375]

### *iv. Discharge of Debt Because of Creditor's Failure to Respond*

In certain circumstances, education debt can be discharged in a Chapter 13 case if the creditor fails to timely object to the debtor's plan of reorganization. A Chapter 13 debtor must serve a copy of her proposed plan on each of her creditors, with notice of the objection deadline.[376] Creditors who fail to object to the plan are bound by the terms of a confirmed Chapter 13 plan.[377] Some debtors have tried to

had enough income to afford payments on the oldest of four loans).

371. *E.g.*, *In re Gharavi*, 335 B.R. 492 (discharging three out of four student loans, but debtor remained liable on one of them); Hollister v. Univ. of N.D. (*In re* Hollister), 247 B.R. 485 (Bankr. W.D. Okla. 2000); Ledbetter v. U.S. Dep't of Educ. (*In re* Ledbetter), 254 B.R. 714 (Bankr. S.D. Ohio 2000).

372. *See* Pincus v. Graduate Loan Ctr. (*In re* Pincus) 280 B.R. 303, 313 (Bankr. S.D.N.Y. 2002); Young v. PHEAA (*In re* Young), 225 B.R. 312 (Bankr. E.D. Pa. 1998).

373. Pa. Higher Educ. Assistance Agency v. Faish (*In re* Faish), 72 F.3d 298, 307 (3d Cir. 1995).

374. *See, e.g.*, *In re Pincus*, 280 B.R. at 311 ("The Bankruptcy Code clearly does not permit a court to discharge in part a single student loan obligation.").

375. *See* Daniel B. Bogart, *Resisting the Expansion of Bankruptcy Court Power Under Section 105 of the Bankruptcy Code: The all Write Act and an Admonition from Chief Justice Marshall*, 35 ARIZ. ST. L.J. 793 (2003); *see also* Amanda M. Foster, *All or Nothing: Partial Discharge of Student Loans Is Not the Answer to Perceived Unfairness of the Undue Hardship Exception*, 16 WIDENER L.J. 1053, 1084 (2007) (asserting that partial discharge is not permitted because under § 523(a)(8), "the entire debt must create an undue hardship.").

376. *See* 11 U.S.C. § 1321 (2012); FED. R. BANKR. P. 3015(b) (2010).

377. 11 U.S.C. § 1327(a) provides, "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not . . . such creditor has objected to,

modify their education loans by simply providing for modification of the loans in their plan without filing an adversary proceeding. This tactic, known as discharge by declaration, first appeared in the 1990s and a number of courts confirmed such plans, considering it a matter of *res judicata* if the creditor did not timely object.[378] Other courts pushed back against what one opinion called "a trap for unwary creditors,"[379] finding that using plan confirmation as a means to avoid an adversary proceeding to discharge student debt was unethical and could subject debtors' counsel to sanctions.[380]

The issue came to a head in the case of *United Student Aid Funds, Inc. v. Espinosa* (*In re Espinosa*).[381] In *Espinosa*, the debtor included payment of student loan principal in his plan, but not payment of interest.[382] The debtor served the creditor with a copy of the plan at the address of the creditor's payment drop box, and although an employee of the creditor saw the plan, the creditor did not file an objection and the plan was confirmed.[383] Years later, when the creditor attempted to collect the debt, the debtor asserted that the debt had been discharged.[384] The Court held that the creditor had received sufficient notice and was bound by the terms of the plan because it failed to object or appeal the confirmation order.[385] But, the Court also ruled that because the Code requires a finding of undue hardship in order to discharge

accepted, or has rejected the plan." 11 U.S.C. § 1327(a).

378. *See* Anderson v. UNIPAC-NEBHELP (*In re* Anderson), 179 F.3d 1253 (10th Cir. 1999) (debtor's plan provided that paying more than ten percent of the education loan would be a hardship); Great Lakes Higher Educ. Corp. v. Pardee (*In re* Pardee), 193 F.3d 1083 (9th Cir. 1999) (plan discharged post-petition interest); *In re* Machado, 378 B.R. 14, 17 (Bankr. Mass. 2007) (the fact that no unsecured creditors objected to favorable treatment of student loan debt showed that the plan did not unfairly discriminate).

379. *In re* Mammel, 221 B.R. 238, 243 (Bankr. N.D. Iowa 1998).

380. *In re* Wright, 279 B.R. 886, 889 (Bankr. D. Kan. 2002) (including student loan discharge provision in order to trap unwary creditor should result in sanctions); *In re* Lemons, 285 B.R. 327, 333 (Bankr. W.D. Okla. 2002) (counsel sanctioned for including discharge provision in plan); *In re* Evans, 242 B.R. 407, 411 (Bankr. S.D. Ohio 1999) (court issued rule to show cause why provision did not violate Bankruptcy Rule 9011).

381. U.S. Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

382. *Id.* at 1374.

383. *Id.*

384. *Id.*

385. *Id.* at 1380.

student loan debt, attempting to do so by means of a plan alone was improper and could subject debtors and their counsel to penalties.[386] Accordingly, bankruptcy courts should not confirm a plan modifying student loan debt if the debtor has not established undue hardship through an adversary proceeding.[387]

*v. Separate Classification of Student Loan Debt in Chapter 13*

Chapter 13 debtors in some jurisdictions have other alternatives to discharge education debt. Section 1322(b)(2) provides that a Chapter 13 plan may "designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated."[388] This is similar to § 1122 in Chapter 11 business bankruptcy, which provides that "[a] plan may place a claim or interest in a particular class only if such claim or interest is substantially similar to the other claims or interests in such class."[389] While this prohibits dissimilar claims from being placed in the same class, § 1122 does not require that all similar claims to be placed in the same class.[390] In Chapter 11 cases, debtors commonly place nonpriority unsecured claims in different classes for purposes of voting on a plan of reorganization. For example, a business debtor may place trade vendors in a different class than claims arising from breach of a collective bargaining unit or claims based upon the unsecured portion of a secured creditor's claim. The interests of these creditors under a plan may be very different, so it makes sense to allow them to vote separately by classes. In addition, for a plan to be confirmed,

386. *Id.* at 1382.

387. *In re* Kinney, 456 B.R. 748, 753 (Bankr. E.D. N.C. 2010) (holding that "inclusion of student loan discharge provisions as part of a Chapter 13 plan without filing an adversary proceeding . . . and without consideration of whether facts exist to support undue hardship, will not be allowed by this Court.").

388. 11 U.S.C. § 1322(b)(1) (2012).

389. *Id.* § 1122(a). The Code does not define substantially similar, but appears to require "classification based on the nature of the claims or interests of classified." H.R. Rep. No. 95-595, at 405 (1977); S. Rep. No. 95-989, at 118 (1978).

390. Travelers Ins. Co. v. Bryson Props., XVIII (*In re* Bryson Props., XVIII), 961 F.2d 496, 502 (4th Cir. 1992).

the proponent needs at least one impaired class to vote to accept the plan.[391] In many instances, a debtor will, in fact, designate a class of similar claims in order to ensure a favorable vote by at least one class.[392]

In contrast to Chapter 11, creditors in a Chapter 13 case do not vote to accept or reject the plan.[393] Therefore, the gerrymandering logic that might drive designation of classes in Chapter 11 does not apply in Chapter 13. And while a Chapter 13 debtor can create separate classes of general unsecured claims, she "may not discriminate unfairly against any class so designated."[394] Education loans, which are not dischargeable and usually extend beyond the three- or five-year duration of the plan, are logically distinct from other general unsecured claims which are discharged upon completion of the plan. Therefore, education loans may logically be classified separately from other general unsecured debt.[395] Moreover, "not all discrimination among classes is prohibited—it is only unfair discrimination that is impermissible."[396] Thus, whether a debtor may classify and treat education loans separately from general unsecured debt depends upon whether the separate classification violates the prohibition against unfair discrimination.

A number of courts have considered whether separate classification of Chapter 13 debt constitutes unfair discrimination. The Eighth Circuit in *In re Leser*, a case dealing with separate classification of delinquent child support claims, adopted this four-part test: (1) whether there is a rational basis for the classification; (2) whether the classification is necessary to the debtor's rehabilitation under Chapter 13; (3) whether the discriminatory classification is proposed in good faith; and (4) whether there is meaningful

391. 11 U.S.C. § 1129(a)(10) (2012).

392. Section 1129(b)(1) provides that the court shall confirm a plan over the objections of one or more class of creditors as long as the plan is fair and equitable and at least one class of impaired creditors has voted to accept the plan. 11 U.S.C. § 1129(b)(1).

393. 11 U.S.C. § 1325(a).

394. *Id.* § 1322(b)(1).

395. *In re* Potgieter, 436 B.R. 739, 743 (Bankr. M.D. Fla. 2010) ("[T]he separate classification of the debtor's student loan obligations does not violate Section 1122."); *In re* Coonce, 213 B.R. 344, 345 (Bankr. S.D. Ill. 1997) (separate classification of student loan debt is permissible).

396. *In re* Mason, 456 B.R. 245, 249 (Bankr. N.D. W.Va. 2011).

payment to the class discriminated against.[397] A number of bankruptcy courts have used the *Leser* test.[398] The bankruptcy court in *In re Husted* (which also addressed child support claims) used the same four factors and added a fifth: (5) the difference between what the creditors discriminated against will receive as the plan is proposed, and the amount they would receive if there was no separate classification.[399] The Ninth Circuit BAP has used similar elements,[400] as have other courts.[401] One court even found that separate classification of student loan debt furthers the "legislative objective of student loan payment."[402]

The First Circuit BAP has established a baseline test of Chapter 13 guiding principles to determine the baseline from which departures can be evaluated for fairness.[403] The considerations include: (1) fairness in the equality of distribution; (2) nonpriority of student loans under the Code; (3) whether dischargeable unsecured creditors receive their full pro rata distribution under Chapter 13; and (4) Chapter 13 exempts student loans from discharge, therefore the debtor does not have an unlimited expectation of a fresh start.[404] While not widely followed, some courts have cited

397. Mickelson v. Leser (*In re* Leser), 939 F.2d 669, 672 (8th Cir. 1991).

398. *In re* Sperma, 173 B.R. 654 (B.A.P. 9th Cir. 1994); *In re* Tucker, 130 B.R. 71, 73 (Bankr. S.D. Iowa 1991) (plan that proposed to pay 100% to student loans and 13% to other unsecured creditors lacked a reasonable basis for discrimination); *In re* Saulter, 133 B.R. 148, 149 (Bankr. W.D. Mo. 1991) (proposed 100% payment to student loans and 10% to other unsecured creditors unfairly discriminated).

399. *In re* Husted, 142 B.R. 72, 74 (Bankr. W.D.N.Y. 1992).

400. Amfac Distrib. Corp. v. Wolff (*In re* Wolff), 22 B.R. 510 (B.A.P. 9th Cir. 1982).

401. *See, e.g.*, *In re* Birts, No. 11-15918-BFK, 2012 Bankr. LEXIS 727, at 8 (Bankr. E.D. Va. 2012) (using the first three factors of *Leser*—rational basis, necessary to reorganization of debtor, and good faith—plus *Husted's* fifth factor—difference to creditors if no separate classification); *In re* Mason, 456 B.R. 245, 252 (Bankr. N.D. W.Va. 2011) (holding that Chapter 13 allows separate treatment of unsecured claims, but requiring debtor to demonstrate at confirmation hearing that seventy-two percent distribution to student loan debts and eight percent distribution to other unsecured creditors is not unfairly discriminatory); *In re* Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010) (adopting the four elements of *Leser*).

402. *In re* Machando, 378 B.R. 14, 17 (Bankr, D. Mass. 2007).

403. *In re* Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001).

404. *Id.* at 240–42.

*Bentley* with approval.[405]

The problem inherent in any multi-factor test is that "unfairness is ultimately a discretionary determination, subject to individual judgment."[406] Courts have struggled to articulate specific criteria, and some have found simply that what is unfair is best left to the "first-line decision maker, the bankruptcy judge."[407] In the end, whether a debtor can classify and treat education debt and general unsecured debt differently really depends upon the jurisdiction and court in which the case was filed, as the following cases show.

a. Cases in which Separate Classification Was Allowed

In *In re Pracht*, the debtor owed $115,934 in student loan debt, and $102,000 in general unsecured debt.[408] The debtor, a special education teacher, was eligible to participate in the Public Service Loan Program.[409] She reached agreement with the U.S. Department of Education whereby she would make 120 consecutive monthly payments of $532.12, after which the remaining amount (approximately $50,000) would be forgiven.[410] In order to obtain the loan forgiveness, she would have to make the payments during her Chapter 13 plan.[411] This meant that her other unsecured creditors, separately classified, would receive a distribution of only 15%.[412] However, if the student loan debt was classified and paid with the other claims, then all unsecured creditors would receive approximately 20% pro rata.[413]

405. *See, e.g.*, *In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003) (plan that proposed to pay two-thirds of nondischargeable debt while unsecured creditors received nothing unfairly discriminated); *In re* Mason, 300 B.R. 379, 386–87 (Bankr. Kan. 2003) (baseline test used to determine that debtor's proposed plan to pay 17% of student loan claims and nothing to dischargeable creditors was unfair).

406. *In re Mason*, 456 B.R. at 251.

407. *In re* Pracht, 464 B.R. 486, 492 (Bankr. M.D. Ga. 2012) (quoting *In re* Crawford, 342 F.3d 539, 542 (7th Cir. 2003)).

408. *In re Pracht*, 464 B.R. at 492.

409. *Id.* at 487.

410. *Id.*

411. *Id.*

412. *Id.*

413. *Id.*

The Chapter 13 trustee objected to the plan. The court found that the plan unquestionably met the requirements of § 1325(b), which requires all of the debtor's projected disposable income be paid to the debtor's unsecured creditors during the plan.[414] The only question was whether the separate classification and higher payment for education loans impermissibly discriminated against the other nonpriority creditors. First, the court noted that the Code does not state *how* the debtor's projected disposable income is to be allocated,[415] nor does the Code define the term, discriminate unfairly.[416] Second, the court observed that courts have struggled to reach a quantifiable definition of the term, and that ultimately, the determination appears to be subjective and best left to the "first-line decision maker, the bankruptcy judge."[417]

In absence of a binding, quantifiable test, the bankruptcy court reasoned that the purpose of bankruptcy is to "to grant a fresh start to the honest but unfortunate debtor."[418] However, this must always be balanced with fairness to creditors.[419] In weighing that balance, the court found in favor of the debtor and approved the plan.[420] The benefit to the debtor was the opportunity to write off $50,000, whereas the benefit to the other creditors if the education loan was not separately classified would be an increase of only $5000, which the court found to be a "modest difference."[421] Thus, the plan did not unfairly discriminate against other

414. 11 U.S.C § 1325(b)(1) provides:

> If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
>
> The value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C § 1325(b)(1) (2012).

415. *In re Pracht*, 464 B.R. at 489.

416. *Id.* at 490.

417. *Id.* at 492 (quoting *In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003)).

418. *Id.* (citing Grogan v. Garner, 498 U.S. 279, 286–87 (1991)).

419. *Id.*

420. *Id.*

421. *Id.*

nonpriority debtors.

Similarly, the court in *In re Birts* confirmed a debtor's plan that paid 7% of allowed unsecured claims (a total of $4299 over sixty months) while keeping current on the debtor's monthly student loan payment of $271 per month, even though paying the student loan debt pro rata with the other unsecured debts would more than double the percentage of payment to unsecured creditors to 16%.[422] The court was particularly compelled by weighing the very positive benefits to the debtor against the marginal real dollar improvement in payments to the creditors, a difference of $92.17 per month divided among all creditors, whose claims totaled over $93,000.[423] "Under the circumstances, the Court finds that the difference of what the creditors are to receive under the Plan, as proposed, and what they would receive if student loan debt were not separately classified, is not so great as to compel a denial of confirmation."[424] The court cautioned, however, that any such finding would be on a case-by-case basis, balancing the "greater disparity between what the creditors are being paid under the [p]lan and what they would receive if the student loan debt [was] not separately classified."[425] The court did not say exactly what the balance might be, except that "a zero percent plan, and one hundred percent payment to student loans may not be a confirmable plan."[426] In another case, the potential increase from 4.14% to 6.76% payment to all unsecured claims if student loan debt was not separately classified was not enough to warrant a finding of unfair discrimination.[427] Yet another court found that separate treatment of education loans and general unsecured was not unfair discrimination as it was necessary for the debtor to maintain her student loan payments to keep her professional license and thus make her plan payments.[428] Of course, if the plan proposes to pay 100% of unsecured claims, then separate classification and full

422. *In re* Birts, No. 11-15918-BFK, 2012 Bankr. LEXIS 727, at *8 (Bankr. E.D. Va. 2012).
423. *Id.*
424. *Id.*
425. *Id*.
426. *Id.*
427. *In re* Machando, 378 B.R. 14, 17 (Bankr. D. Mass. 2007).
428. *In re* Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009).

payment of student debt is always permissible.[429]

As noted previously, there sometimes is a difference between the amount of disposable income calculated using Form 22C and the debtor's *actual* income. This is because Form 22C uses statutory amounts for expenses. Some are based upon IRS allowances, and others are based on Department of Labor statistics, such as state and local median income figures.[430] This means that some debtors may actually have higher incomes than the amount calculated using Form 22C. In these circumstances, debtors have successfully proposed plans in which all of their disposable income, as calculated under Form 22C, is used to pay general unsecured creditors, and the excess amount is used to pay education debt.[431]

A third line of cases has found that where the school debt is payable beyond the life of the plan, the unfair discrimination test of § 1322(a)(1) does not apply. This is based upon an expansive reading of § 1322(b)(5), which states that a Chapter 13 plan shall "provide for the curing of any default . . . and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."[432] So, if payments on the student loan debt extend beyond the five years of the plan,

429. *In re* Potgieter, 436 B.R. 739 (Bankr. M.D. Fla. 2010); *see also* Cameron M. Fee, *An Attempt at Post-Mortem Revival: Has § 1322(b)(10) Been Euthanized?*, 31 AM. BANKR. INST. J., 38 (2012). Fee asserts that § 1322(b)(10) appears to provide that post-petition interest on nondischargeable unsecured claims may only be paid after making provision for full payment of all allowed claims. *Id.* However, Fee points out, the only published opinion to address § 1322(b)(1) found it unenforceable as inconsistent with § 1322(b)(5). *Id.*

430. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

431. *In re* Abaunza, 452 B.R. 866 (Bankr. S.D. Fla. 2011); *In re* King, 460 B.R. 708, 713–14 (Bankr. N.D. Tex. 2011) (demonstrating that an unfair discrimination test allows for higher payments to certain creditors as long as unsecured creditors receive their pro rata share of statutory projected disposable income); *In re* Sharp, 415 B.R. 803, 812 (Bankr. D. Colo. 2009) (finding that § 1325(b) does not require debtors to pay more to creditors than the statutory projected disposable income); *In re* Orawsky, 387 B.R. 128, 148–56 (Bankr. E.D. Pa. 2008) (showing that if payments to education creditor came from funds the debtor is not obligated to commit to the plan). *Contra In re* Cooper, 2009 WL 1110648, at *5 (Bankr. N.D. Tex. April 24, 2009) (finding that an above-median income debtor may not discriminate among non-priority unsecured creditors).

432. 11 U.S.C. § 1322(b)(5) (2012).

then the plan can provide for maintenance of the regular loan payments.[433] For courts adopting this view, the authority to continue payments on long-term debt under § 1322(b)(5) trumps the unfair discrimination criteria of § 1322(b)(1).[434] This approach has been rejected by a number of courts and is a minority view.[435]

b. Cases in which Separate Classification Was Not Allowed

A Wisconsin bankruptcy court did not allow separate treatment of education debt in *In re Edmonds*.[436] In that case, the debtor proposed to treat her three education loans as a separate class and to pay the contract rate of principal and interest.[437] At the end of the five-year plan, education creditors would have received a 53% dividend, while the other unsecured creditors would receive only 18% and their claims would be discharged.[438] If the payments to education creditors were included in the same class as the other creditors, the dividend to all unsecured creditors would be 28%.[439] The Chapter 13 trustee objected to the plan on the grounds of unfair discrimination.[440] In sustaining the objections, the court stressed that it was not holding that student loans could *never* be separately classified.[441] However, because the debtors were fully employed and had a good income, "[t]here is nothing in the case at bar which establishes that the debtors are unable to formulate a plan that provides for equal treatment of unsecured debtors. Student loan debts should not be paid at the expense of the

433. *In re* Johnson, 446 B.R. 921, 926 (Bankr. E.D. Wis. 2011) ("Section 1322(b)(5) expressly permits a debtor to cure and maintain payments on a long-term debt; and the Debtor's student loans qualify.").

434. *See, e.g.*, *In re* Truss, 404 B.R. 329 (Bankr. E.D. Wis. 2009); *In re* Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007); *In re* Machando, 378 B.R. 14, 16 (Bankr. D. Mass. 2007); *In re* Hanson, 310 B.R. 131 (Bankr. W.D. Wis. 2004).

435. *See, e.g.*, *In re* Zeigafuse, 2012 WL 1155680 at *3 (Bankr. D. Wyo. 2012) (finding that interpreting § 1322(b)(5) to allow for full payment of student loan debt while other general unsecured debt is paid pro rata is minority view); *see also In re* Edmonds, 444 B.R. 898, 900 (Bankr. E.D. Wis. 2010).

436. *In re Edmonds*, 444 B.R. 898.

437. *Id.* at 900.

438. *Id.*

439. *Id.*

440. *Id.*

441. *Id.* at 902.

other general unsecured creditors."[442] For the *Edmonds* court, because the debtors had sufficient income to carry out a plan without discrimination, they must do so.

In another case, the First Circuit BAP affirmed a bankruptcy court ruling disallowing debtor's proposed plan to pay student obligations in full while paying other unsecured creditors only 3%.[443] The BAP held that the principal of equality of distribution for unsecured creditors mandated that the debtor could not favor certain creditors without providing a correlative benefit to other unsecured creditors.[444] A Colorado bankruptcy court found unfair discrimination where debtor's plan proposed to pay student loan claims at 64% while other unsecured claims received only 1%.[445] The court required the debtor to pay student loan payments pro rata with other claims, resulting in a distribution of 12% to all unsecured creditors.[446]

*vi. Education Debt as Special Circumstances*

Another line of cases permits the debtor to deduct his monthly student loan payments from expenses for purposes of Form 22C in determining the debtor's monthly projected disposable income. This is based upon the § 707(b), which is the means test for Chapter 7 debtors. Section 707(b)(1) provides that the court shall dismiss a Chapter 7 case (or convert it to Chapter 13 with the debtor's permission), if granting relief under Chapter 7 would constitute an abuse of the Chapter 7 process.[447] Section 707(b)(2)(A) sets forth the types of expenses that may be deducted from the debtor's income in order to calculate the debtor's monthly disposable income.[448] It provides that the court shall presume abuse if the debtor's monthly income, minus allowed deductions, exceed certain statutory maximum amounts.[449] In the event

442. *Id.*
443. *In re* Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001).
444. *Id.* at 243.
445. *In re* Renteria, 2012 WL 1439104, at *5 (Bankr. Colo. Apr, 26, 2012).
446. *Id.*
447. 11 U.S.C. § 707 (b)(1) (2012) (providing that the court may dismiss a Chapter 7 case "if it finds that the granting of relief would be an abuse of the provisions of this Chapter").
448. *Id.* § 707(b)(2)(A).
449. *Id.*

that the debtor's income exceeds the maximum amount, § 707(b)(2)(B) allows the debtor to rebut the presumption of abuse by demonstrating "special circumstances . . . to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative." [450]

For debtors with income above the state median, § 1325(b)(3) incorporates the Chapter 7 means test into the disposable income test for Chapter 13.[451] Therefore, courts can consider whether the nondischargeable nature of student loan debts constitutes the requisite special circumstances that permit the payments to be deducted as allowable expenses under a Chapter 13 plan. So, some courts have held that since the debtor has no reasonable alternative but to pay nondischargeable student loans, such loans constitute special circumstances.[452] Another court reasoned that hardship would result from the accumulation of interest if the education loans were treated the same as other undersecured debt.[453] Still another court ruled that education loans could constitute special circumstances, depending on the debtor's motivation in incurring the student debt.[454] In that case, the court held that pursuit of higher education solely for increased earning potential or career advancement could not constitute special circumstances, but that educational loans incurred for education and training "necessitated by permanent injury, disability or an employer closing," could constitute the requisite special circumstances.[455]

This line of cases is a minority view. Most courts have held that the fact that student loan debt is not dischargeable does not, without more, justify separate classification.[456]

450. *Id.* § 707(b)(2)(B).

451. *Id.* § 1325(b)(3) (providing that "amounts reasonably necessary to be expended [for purposes of determining disposable income] shall be determined in accordance with . . . § 707(b)(2)" if the debtor's income exceeds the state median income).

452. *In re* Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007); *In re* Delbecq, 368 B.R. 754, 759 (Bankr. S.D. Ind. 2007); *In re* Templeton, 365 B.R. 213 (Bankr. W.D. Okla. 2007).

453. *In re* Martin, 371 B.R. 347, 356 (Bankr. C.D. Ill. 2007).

454. *In re* Pageau, 383 B.R. 221 (Bankr. D.N.H. 2008).

455. *Id.* at 228.

456. *In re* Willis, 197 B.R. 912 (N.D. Okla. 1996) (finding that nondischargeability by itself is insufficient for preferential treatment of student

Indeed, some courts have opined that because borrowing to fund an education is almost universal, student loans are not special and therefore not dischargeable.[457]

### *C. Student Loan Debt in Bankruptcy—Quantitative Data*

To better understand the incidence of education loan debt in bankruptcy, I obtained data from fifty consumer Chapter 7 and Chapter 13 cases filed each year in ten randomly selected jurisdictions from 2004 to 2011.[458] Of the approximately 3750 cases I reviewed, 814 reported student loan debt. The table below shows the percentage of cases in which the debtor(s) reported student loan debt for each year, and the average amount of student loan debt per case.

| | **Chapter 7** | | **Chapter 13** | |
|---|---|---|---|---|
| Year | Percent w/ student debt | Average student loan debt | Percent w/ student debt | Average student loan debt |
| 2004 | 18.0 | $18,484 | 14.6 | $13,332 |
| 2005 | 18.9 | $12,545 | 14.7 | $23,208 |
| 2006 | 19.0 | $16,644 | 22.2 | $16,304 |
| 2007 | 23.2 | $21,055 | 22.1 | $21,699 |
| 2008 | 19.9 | $28,213 | 19.1 | $17,497 |
| 2009 | 21.8 | $29,992 | 22.0 | $26,908 |

loan debt over other debt); *In re* Colfer, 159 B.R. 602, 608–09 (Bankr. Me. 1993).

457. *See, e.g.*, *In re* Johnson, 446 B.R. 921, 925 (Bankr. E.D. Wis. 2011) ("The commonplace nature of student loans to fund higher education suggests that they are not 'special,' as they are part of the financial picture of many Americans."); *In re* Carrillo, 412 B.R. 540 (Bankr. D. Ariz. 2009) (finding that ordinary course student loans are not special circumstances); *In re* Vaccariello, 375 B.R. 809, 816 (Bankr. N.D. Ohio 2007).

458. The jurisdictions include Arkansas' Eastern District, Arizona, California's Southern District, Georgia's Middle District, Indiana's Southern District, New York's Northern District, Oklahoma, Oregon, Pennsylvania's Western District, and Wisconsin's Eastern District. Electronic filing was not fully available in Georgia, Indiana, and Wisconsin in 2004, so these jurisdictions were not included for that year. This data is based on amounts reported by debtors on Schedules E (priority unsecured debt) and Schedule F (general unsecured debt). The data presents a general view of student loan debt, and does not purport to be an exact accounting of student loan debt. For example, many student loan debts were listed in round numbers (i.e., $15,000) whereas the actual amount owed was likely not such a simple number. In addition, as with many debts, debtors may have estimated the amount. Also, the data does not differentiate between debtors filing singly and those filing jointly. Finally, the data adjusts for a statistical anomaly in a 2004 Chapter 7 case.

| | | | | |
|---|---|---|---|---|
| 2010 | 21.3 | $21,360 | 24.2 | $24,396 |
| 2011 | 24.3 | $25,096 | 22.3 | $26,483 |

There are some anomalous results. For example, there was a significant decline in student debt reported in Chapter 13 cases in 2006. In addition, the amount of debt per case peaked in 2009, which was the height of the recession. And while it eased back in 2010, by 2011 the average student loan debt was again on the rise. Cleary, student loan debt is an increasing factor in consumer bankruptcy.

My review of bankruptcy cases also revealed that debtors overwhelmingly self-select to not discharge student loan debt in bankruptcy. Of the 814 cases with student loan debt, only two Chapter 7 debtors and one 13 Chapter debtor filed adversary proceedings to have their student loans discharged. In a 2009 Chapter 7 case, the debtor obtained a discharge of $79,000 in student loans by establishing undue hardship as a result of severe injuries received in a car accident. The debtor in a 2011 Chapter 7 case withdrew her adversary proceeding to discharge $15,000 in private student loan debt after a settlement with the creditor to pay most of her debt. In the Chapter 13 case, the debtor listed a student loan claim of $47,890 on Schedule F, but asserted in his adversary proceeding that his signature on the loan was a forgery and that had been unaware of it until the debtor defaulted and the creditor sought to collect against him. The court ultimately entered an order that the debt not be excepted from discharge, and the debt was discharged.

Even in seemingly plausible cases the debtors did not attempt to have the debt discharged. In one case, married debtors had an income consisting of the husband's modest salary as a pressman, which put them below the state median income. With expenses, including student loan payments of $218 per month, the debtors showed negative monthly income of $267.26 per month. They live in a home valued at $149,000 against which there are two mortgages, the second one being mostly unsecured. Yet their combined education debt is $71,000, with an additional $25,000 of general unsecured debt. The debtors clearly cannot afford to repay the student loan debt, yet they elected not to attempt to discharge the debt. A number of the cases I reviewed showed

debtors with high five-figure or six-figure student loan debt and modest income, but they did not attempt to have the debt discharged. It seems likely that at least some of these debtors will never be able to pay their student debt, but seemingly, the undue hardship standard is out of reach for them.

Two recent studies of student loan debt in bankruptcy provide additional insight into the treatment of student loans in bankruptcy.[459] Rafael Pardo and Michelle Lacey examined 261 published hardship opinions from 1993 to 2003.[460] Pardo and Lacey concluded that nearly half (45%) of debtors who filed an adversary proceeding for an undue hardship discharge were successful in obtaining some relief.[461] Furthermore, debtors who obtained a student loan debt discharge had lower monthly incomes, lower monthly expenses, and were more likely to have a medical problem or a dependant with a medical problem.[462] More recently, Jason Iuliano examined 207 cases, finding that the debtor's medical hardship, employment, and income in the year prior to filing bankruptcy are predictive of discharge.[463]

## III. EDUCATION DEBT: FINANCIAL AND MORAL QUAGMIRE

### *A. Distress, Delinquency, and Default*

Overwhelming education debt is not simply the common misfortune of unlucky or imprudent individuals. Rather, the creation and persistence of a student loan indentured class has severe negative implications for the nation as a whole.

#### *1. Distress*

The American middle class is in severe economic distress and likely to stay that way for a long time. Foreclosures,

459. Jason Iuliano, *An Empirical Assessment of Student Loan Discharges and the Undue Hardship Standard* AM. BANKR. L.J. (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1894445; Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Education Debt*, 74 U. CIN. L. REV. 405 (2005).

460. Pardo & Lacy, *supra* note 459.

461. *Id.* at 479.

462. *Id.* at 481–86. However, Pardo and Lacey later suggest that the specific judge deciding the case and the experience of the debtor's lawyer may be equally important variables in the outcome of the case. *See*, Pardo & Lacey, *supra* note 459, at 227–32.

463. Iuliano, *supra* note 459, at 7, 23–26.

underwater mortgages, job losses, income stagnation, and other factors are taking a huge toll on the ability of Americans to afford such basics as housing, education, and health care.[464] The problems of education debt are likely to grow more acute due to lower government funding for education and stagnating income in a tough economy.[465] A recent report concludes that rising levels of student debt cause many Americans to delay events such as buying a car, purchasing a home, getting married, and even having children.[466] As one borrower laments, "[h]ow could I consider having children if I can barely support myself?"[467] Some people even avoid dating other people whose student debt level seems excessive.[468]

People under crushing debt burdens suffer long-term adverse health effects. Financial stress "can . . . contribute to a sense of continuing entrapment and hopelessness that can in turn serve to extend an episode."[469] People with serious debt are more likely to suffer from a multitude of health problems including migraines and headaches, stomachaches, back pains, increase risk of cardiovascular disease, and hypertension, as well as psychological disorders, such as depression.[470] High debt is also associated with incidence of higher mortality, including suicide.[471] And, it affects

464. Katherine Porter, *Bankruptcy and Financial Failure in American Families*, *in* BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS 1, 3–6 (Katherine Porter ed., 2012).

465. Chris Staiti, *Student Loan Debt Could Become the Next Financial Bubble, S&P Says*, BLOOMBERG (Feb. 9, 2012, 12:58 PM), *http://mobile.bloomberg.com/news/2012-02-09/student-loan-debt-could-become-next-financial-bubble-s-p-says*.

466. NAT'L ASS'N OF CONSUMER BANKR. ATTY'S, THE STUDENT LOAN "DEBT BOMB": AMERICA'S NEXT MORTGAGE-STYLE ECONOMIC CRISIS? i (2012), *available at* http://www.nacba.org/Legislative/StudentLoanDebt.aspx.

467. Shellenbarger, *supra* note 168.

468. Jennifer Ludden, *Call Me Maybe When Your School Loan is Paid in Full*, NPR NEWS (Jul. 16, 2012), http://www.wbur.org/npr/156736915/call-me-maybe-when-your-school-loan-is-paid-in-full.

469. George W. Brown, *Social Roles, Context and Evolution in the Origins of Depression*, 43 J. HEALTH & SOC. BEHAV. 255, 269 (2002).

470. Mechele Dickerson, *Vanishing Financial Freedom*, 61 ALA. L. REV. 1079, 1119 (2010) (summarizing multiple studies on debt and health); Patricia Drentea, *Age, Debt and Anxiety*, 41 J. HEALTH & SOC. BEHAV. 437, 437 (2000) (noting correlation between high debt-to-income ratio and anxiety).

471. Dickerson, *supra* note 470, at 1119. In a well-publicized incident, the husband of a star on the reality TV show Housewives of Beverly Hills

individual health in that debtors are more likely to avoid or delay medical and dental care.[472] Other effects include lower self-esteem, social isolation, chronic tension, and family problems including higher divorce rates.[473] A 2004 study of debt and depression[474] concludes that severe and prolonged economic stress causes biomedical, physiological, cognitive, and behavioral changes.[475] Consequences for families in financial stress include hostility and increased risk of divorce among parents, depression, bad behavior, and poor school performance in children.[476]

Numerous blogs deal with student loan debt, depression, and other social problems caused by crushing student loan debt.[477] In a recent account, a law graduate who was unable to pass the bar took a string of different jobs, but eventually defaulted on his loan.[478] Although the loans are presently in deferment status, interest is adding $2000 to the balance each month.[479] His loan debt destroyed his marriage and eroded his mental outlook.[480] His student loan debt will be with him his entire life. Debt levels of this nature will prevent graduates from pursuing public interest careers, or

committed suicide in part because of extreme indebtedness. Emily Starbuck Crone, *Emily's List: Debt and Depression Edition*, CREDITCARD.COM BLOG (Sept. 2, 2011) http://blogs.creditcards.com/2011/09/emilys-list-debt-and-depression.php (last visited Apr. 12, 2013).

472. Melissa B. Jacoby, *Health, Law, and Everyday Life: Does Indebtedness Influence Health? A Preliminary Inquiry*, 30 30 J.L. MED. & ETHICS 560, 560 (2002).

473. *Id.* at 562.

474. CHRISTOPHER G. DAVIS & JANET MANTLER, THE CONSEQUENCES OF FINANCIAL STRESS FOR INDIVIDUALS, FAMILIES, AND SOCIETY 2 (2004), *available at* http://doylesalewski.ca/wp-content/uploads/Carleton%20Report%20-%20Financial%20Distress.pdf?phpMyAdmin=d3062932296aa4d592c757936733fff8&phpMyAdmin=DsWwS7g4UVLBVi3NJBYbNwQsDA2.

475. *Id.* at 2.

476. *Id.* at 8.

477. *See, e.g.*, *Taegan Goddard's Coverage on Mounting Defaults*, ALL EDUC. MATTERS, (Mar. 30, 2013, 4:08 PM), *It's Hard Out There for a Grad*, http://alleducationmatters.blogspot.com; B$ IN DEBT, http://bsindebt.com (last visited Apr. 12, 2013).

478. Debra Cassens Weiss, *Law Grad's Ballooning Student Debt Will Exceed $1.5M by the Time He Retires,* ABA JOURNAL (Feb. 28, 2012, 8:34 AM), http://www.abajournal.com/news/article/law_grads_ballooning_student_debt_will_exceed_1.5m_by_the_time_he_retires/.

479. *Id.*

480. *Id.*

lower paying but socially important jobs such as teaching.[481]

*2. Delinquency and Default*

Education loan delinquency and default is on the rise.[482] Until 2012, the U.S. Department of Education tracked student loan default in units of two-year cohorts; i.e., the default rate of borrowers who have been in repayment for two years.[483] For borrowers who entered repayment in 2009, 8.8% (320,000 borrowers) had defaulted by the end of 2010.[484] This was an increase from 7% for borrowers who entered repayment in 2008.[485] For-profit schools have the highest two-year default rate at 15%, while the rate at public colleges is 7.2% and the rate at private nonprofit is 4.6%.[486]

But the two-year default analysis may hide the actual reality. Currently, some 14% of all student borrowers default on their loans within three years of graduation.[487] For some programs, the default rate is much higher. For example, fifteen-year defaults on loans made to students at community colleges are 31%.[488] At for-profit schools, 96% of students take out education loans,[489] but only 36% are currently paying down the principal on their student loans, and 22% of the

481. *See* SANDY BAUM & DIANE SAUNDERS, LIFE AFTER DEBT: RESULTS OF THE NATIONAL STUDENT LOAN SURVEY: FINAL REPORT (1998).

482. *See* CUNNINGHAM & KIENZL, *supra* note 130, at 8. A borrower is delinquent if she misses one payment. After nine months of delinquency a borrower is in default. *Id.*

483. THE PROJECT ON STUDENT DEBT, SHARP UPTICK IN STUDENT LOAN DEFAULT RATES (2011), *available at* http://projectonstudentdebt.org/files/pub/Sept_2011_CDR_NR.pdf.

484. *Id.*

485. *Id.*

486. *Id.*

487. Len Boselovic, *Newly Minted Grads Face Loan Loads*, PITTSBURGH POST-GAZETTE, (Mar. 30, 2012, 12:10 AM), http://www.post-gazette.com/stories/business/heard-off-the-street/newly-minted-grads-face-loan-loads-294820/. This average is skewed by a twenty-five percent default rate for borrowers who attended for-profit colleges with programs such as auto mechanics, criminal justice, and medical technology. Default rate for students at public schools is 10.8%, and for students at private nonprofit schools is 7.6%. *Id*.

488. Kelly Field, *Government Vastly Undercounts Defaults*, THE CHRONICLE OF HIGHER EDUC. (July 11, 2010), http://chronicle.com/article/Many-More-Students-Are/66223.

489. COLL. BD. ADVOCACY & POLICY CTR., TRENDS IN COLLEGE PRICING 2011, at 13 (2011), *available at* http://trends.collegeboard.org/sites/default/files/College_Pricing_2011.pdf.

loans are in default within three years of leaving school.[490] Analysis by the Federal Reserve Bank of New York for third quarter of 2011, taking deferral and other factors into consideration, suggests that loan repayment problems may be even greater. It calculates that overall, 47% of student loan borrowers were in deferral or forbearance and that 27% of borrowers had a past due balance, with 21% of total loans delinquent or in default.[491]

In 2012, the U.S. Department of Education switched to reporting rates for three years of repayment. It is expected that the 2008 default number will double to 13.8%.[492] When looked at for a longer period of time, the default rate is even higher. For graduates who entered loan repayment in 2005, 25% have been delinquent at some point, and 15% have defaulted.[493] Only 40% of borrowers are in repayment as agreed.[494] Others are in deferment or default. According to one source, one in every five loans in repayment since 1995 may be in a default, with the number for nonprofit schools at 40%.[495]

A 2011 study by the Institute for Higher Education Policy examined federal student loan repayment history for borrowers who entered repayment between 2004 and 2009, and in particular, focused on borrowers whose repayments date from 2005.[496] The study looked at 8.7 million borrowers, representing 27.5 million loans totaling $148 billion.[497] Of the 2005 group (1.8 million borrowers with $38.4 billion in loans), only 37% of borrowers (667,000 borrowers with $13.1 billion in loans) were repaying their loans on time and without deferrals or restructuring as of 2009.[498] About 23% were in

490. U.S. S. HEALTH, EDUC., LABOR, & PENSIONS COMM., FOR PROFIT HIGHER EDUCATION: THE FAILURE TO SAFEGUARD THE FEDERAL INVESTMENT AND ENSURE STUDENT SUCCESS 8 (2012), *available at* http://www.help.senate.gov/imo/media/for_profit_report/PartI.pdf.

491. Brown et al., *supra* note 6. These numbers exclude loans that have been charged off on the credit report.

492. Harris, *supra* note 113.

493. CUNNINGHAM & KIENZEL, *supra* note 130, at 8.

494. *Id.*

495. Field, *supra* note 488.

496. CUNNINGHAM & KIENZEL, *supra* note 130, at 8. This study did not include private loan repayment.

497. *Id.* at 16.

498. *Id.* at 18.

forbearance or deferment, 26% were delinquent but had not defaulted, and 15% had defaulted.[499] Default rates are much lower for students who graduate from four-year public or nonprofit institutions, with close to half making timely payments, whereas only 25% of the borrowers who attended for-profit and two-year colleges were making timely payments, and more than 50% of the borrowers in these sectors had defaulted.[500]

Young student borrowers will eventually become middle-age student borrowers, and far more of them will carry far more student loan debt than their parents did. A potential harbinger of things to come may be discerned in the experience of today's middle-aged (over age fifty) generation, of whom 16% of people have student loan debt.[501] The delinquency rate for all borrowers is 8.7%, but for borrowers aged forty to forty-nine, it is 11.9%,[502] and for those aged fifty to fifty-nine the delinquency rate is even higher at 15.5%.[503] Many people later in life are still paying balances from college at a time when the value of homes and investments has declined.[504] Moreover, non-federal lenders almost always require parents or others to cosign. Currently 90% of private loans require parents to cosign, up from 50% in 2008,[505] thus linking generations together in student loan debt.

For-profit schools have a particularly poor repayment record. On July 30, 2012, the Senate Committee on Health, Education, Labor, and Pensions released a scathing report dealing with for-profit schools.[506] At for-profit schools, over 54% of students who commence full-time studies do not

499. *Id.* at 19.

500. *Id.* at 21.

501. Kristen Stenerson, *Nearly 16 Percent Of Post 50s Are Carrying Student Loan Debt*, THE HUFFINGTON POST, (July 13, 2012, 7:12 PM), http://www.huffingtonpost.com/2012/07/13/student-loan-debt_n_1668797.html.

502. Josh Mitchell, *Student Debt Hits the Middle-Age*, WALL ST. J., (July 17, 2012, 7:22 PM), http://online.wsj.com/article/SB10001424052702303612804577533332860797886.html.

503. Stenerson, *supra* note 501.

504. *Id.*

505. *Student Loans Sink Mom and Dad*, MSN MONEY (July 19, 2012, 4:03 PM), http://money.msn.com/saving-money-tips/post.aspx?post=24383a62-f419-471b-a45f-b882fe0c3741.

506. U.S. S. HEALTH, EDUC., LABOR, & PENSIONS COMM., *supra* note 479, at 73.

complete their programs.[507] This is far higher than the 35% of students at nonprofit schools who fail to do so, and leaving a program significantly increasing the probability of defaulting on student loans.[508] The Department of Education estimates that 46.3% of dollars lent to for-profit students who entered repayment in 2008 will default.[509] The number for two-year public and nonprofit colleges is 31.1%.[510] One for-profit school even estimates its own student default rates may be as high at 77%.[511] Overall, for-profit students constitute approximately 10% of all higher education students, but account for 25% of all education loans, and almost 50% of education loan defaults.[512]

There are plenty of negative consequences for debtors who default. For those with federal student loans, the government can seize wages, tax refunds, earned income tax credits, and social security payments.[513] Defaulters are liable for the original principal balance, all accrued interest, court costs, and any collection fees, which are all added to the

507. *Id.*

508. Satyajit Chatterjee & Felicia Ionescu, *Insuring Student Loans Against the Risk of College Failure* 2 (Research Dep't, Fed. Reserve Bank of Philedelphia, Working Paper No. 10-31 ) *available at* http://www.phil.frb.org/research-and-data/publications/working-papers/2010/wp10-31.pdf.

509. U.S. S. HEALTH, EDUC., LABOR, & PENSIONS COMM., *supra* note 490, at 116.

510. *Id.*

511. *Id.* at 117. One commentator critical of for-profit student loan lenders states that any lender that anticipates a default rate of fifty percent or more "is just a con artist bent on ripping people off. Period." Mike Whitney, *An Orgy of Speculation*, PHIL'S STOCK WORLD (Mar. 1, 2011), http://articles.businessinsider.com/2011-03-02/markets/30075693_1_hedge-fund-managers-qe2.

512. Alison O'Brien, *Investigation Reveals Claims of Unmanageable Debt by 'For-profit' College Students,* MSNBC (July 19, 2012), http://rockcenter.msnbc.msn.com/_news/2012/07/19/12842350-investigation-reveals-claims-of-unmanageable-debt-by-for-profit-college-students?lite. The article includes comments by former employees of one of the second largest for-profit education corporations, Education Management Corporation, to the effect that student recruiting was little more than a siphon for federal student loan dollars. The article and the Comments section also claim that many for-profit schools admit students with scant regard for academic qualifications and that instructors are pressured not to fail students. As one commentator, a former instructor, said, "if they have a 'pell (grant) and a pulse' they are in." *Id.*

513. Steverman, *supra* note 152.

outstanding balance.[514] In addition, the negative credit rating that results from default may make it harder to obtain mortgages, car loans, and credit cards, and possibly even apartments or jobs. When they do get loans, they will pay higher interest rates.[515] Unlike any other type of debt, there is no statute of limitations.[516]

Experts who follow student loan delinquencies are increasingly pessimistic about the health of student loan portfolios. In a survey of bank risk professionals in the last quarter of 2011, 67% expected student loan delinquencies to rise, up from 48% in the third quarter of 2011.[517]

Student loan debt collecting can be a lucrative business. Companies such as Education Management Corporation work under contract with the U.S. Department of Education to service loans and collect on defaulted accounts.[518] The companies charge fees to borrowers and earn commissions from taxpayers of up to 31% for collecting on defaulted loans.[519] Collectors can garnish wages, taking a percentage as a fee before forwarding the rest to the government.[520] Executive salaries and employee bonuses at collection firms can run into six- and seven-figures.[521] Private debt collection agencies recovered $11.3 billion in defaulted loans in 2011, approximately eighty-five cents on every dollar that defaults.[522] For their efforts, debt collectors received about $1

514. CUNNINGHAM & KIENZL, *supra* note 130, at 15.

515. Field, *supra* note 488.

516. Higher Education Technical Amendments Act of 1991, Public Law 102-26, (codified at 20 U.S.C. § 1091a(a)).

517. *Student Loans Seen as Next Casualty of Sluggish Economy, FICO Quarterly Survey Finds*, FICO, (Jan. 11, 2012), http://www.fico.com /en/Company/News/Pages/01-11-2012a.aspx. As one analyst noted, "[e]vidence is mounting that student loans could be the next trouble spot for lenders. A significant rise in defaults on student loans would impact lenders as well as taxpayers, who could be facing big losses due to these defaults." *Id*.

518. John Hechinger, *Taxpayers Fund $454K for Chasing Student Loans*, BLOOMBERGBUSINESSWEEK (May 15, 2012), http://www.businessweek.com/news /2012-05-15/taxpayers-fund-454-000-pay-for-collector-chasing-student-loans.

519. *Id.*

520. *Id.* In one case ECMC seized $600 per month from the pay of a sixty-one year old teacher, but kept $96 (16%) as a fee. *Id*.

521. *Id.*

522. John Hechinger, *Obama Relies on Debt Collectors Profiting From Student Loan Woe*, BLOOMBERG, (Mar 26, 2012), http://www.bloomberg.com /news/2012-03-26/obama-relies-on-debt-collectors-profiting-from-student-loan-woe.html.

billion.[523] During the same time, however, the Federal Trade Commission received some 181,000 complaints—more than any other industry—about abusive debt collection practices.[524] While this number includes all types of debt collection (credit cards, late auto loan payments, etcetera[525]), student loan debtors often experience abusive debt collection, including incessant phone calls to home and work numbers at all hours, bullying, misrepresentation, and threats.[526]

The Department of Education has sought to restrict participation in Title IV access to education loans for non-degree granting vocational programs that fail to meet certain threshold repayment requirements. Under regulations promulgated in June 2011 (known as the Debt Measure Rule), the Department established a minimum standard of 35% for loan repayment rate, and a maximum standard of 30% discretionary income and 12% of annual earnings for debt-to-earnings ratios.[527] The purpose of the regulation was to ensure that government-guaranteed loans only went to programs that prepared students for gainful employment in a recognized occupation.[528] A program would be considered failing if its debt measures did not meet any of the minimum standards.[529] Such institutions would be required to warn current and prospective students, and to describe the actions that the institution planned to take to improve its performance.[530] A program that failed the debt measure in any two out of three years would be required to provide additional warnings to current and prospective students, including "[a] clear and conspicuous statement that a student who enrolls or continues in the program should expect to have

523. *Id.*

524. *Id.*

525. *See, e.g.*, Allie Johnson, *True Debt Collection Horror Tales*, CREDITCARDS.COM (July 24, 2012), http://www.creditcards.com/credit-card-news/true-debt-collection-horror-tales-1282.php?a_aid=9fc4cb60 (giving examples of abusive debt collection practices).

526. Kelly Field, *Complaints Soar Over Student-Loan Collections*, THE CHRONICLE OF HIGHER EDUC. (May 6, 2012), http://chronicle.com/article/Complaints-Soar-Over/131781/.

527. Debt Measure Rule, 76 Fed. Reg. 34,386, 34,395 (2011) (describing 34 C.F.R. § 668.7(a)(1)) (2010).

528. 34 C.F.R. § 600.10(c)(1).

529. *Id.* § 668.7(h).

530. *Id.* § 668.7(j)(1).

difficulty repaying his or her student loans."[531] If a program failed to satisfy the debt measure in three out of any four years it would lose its Title IV eligibility[532] and be barred from seeking to reestablish the program, or a substantially similar program for three years.[533]

In July 2011, The Association of Private Sector Colleges and Universities filed suit in the District Court for the District of Columbia to enjoin enforcement of the Debt Measure Rule.[534] On June 30, 2012, the District Court entered its opinion in the case. The court held that although the agency has authority to issue rules such as the debt-to-income ratio,[535] the agency failed to establish a reasoned basis for the debt-repayment benchmark, which the court found was arbitrary and capricious. [536] Since the repayment test could not be severed from the other debt measures, the court vacated the entire debt measure rule.[537] In the short term, for-profit schools were clearly the winners of the ruling, as many of their programs would have failed the test.[538]

### *B. Moral Morass*

#### *1. Education Debt as Moral Malfeasance*

Debtors' prisons were common in colonial America.[539] Under English law and in the early American republic, punishment for debt was punishment as much against the person of the debtor, and not just against his property. Over time, debtor's prisons were abolished in America and debt became resolved through insolvency laws—first under individual state insolvency laws, and then under federal

531. *Id.* § 668.7(j)(2)(i)(D).
532. *Id.* § 668.7(i).
533. *Id.* § 668.7(1)(2)(ii).
534. Ass'n. of Private Colls. & Univs. v. Duncan, 870 F. Supp. 2d 133 (D.D.C. 2012).
535. *See id.* at 152.
536. *Id.* at 137.
537. *Id.*
538. Goldie Blumenstyk & Charles Huckabee, *Judge's Ruling on 'Gainful Employment' Give Each Side Something to Cheer*, THE CHRONICLE OF HIGHER EDUC. (July 2, 2012), http://chronicle.com/article/Ruling-on-Gainful-Employment/132737/.
539. BRUCE MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE 78–108 (2002).

bankruptcy laws.[540] With debt as a financial offense, society could construct a financial resolution. Through discharge of debts, debtors and their families could resume productive lives in society, and avoid becoming a public charge. To achieve this, bankruptcy law shifts the risk of default to the debtor's creditors, allowing the honest but unfortunate debtor a fresh start.[541]

There are several types of financial obligations which are not dischargeable in bankruptcy. Tellingly, a number of these obligations arise from moral culpability of the debtor. Thus, debts incurred by fraud,[542] breach of fiduciary trust,[543] willful acts causing bodily harm,[544] death or injury caused while intoxicated,[545] and taxes the debtor has tried to evade by not filing a tax return,[546] are not dischargeable in bankruptcy. Also nondischargeable are domestic support obligations owed to spouses or children.[547] These obligations reflect deep social and personal duties, not just financial ones, and their nondischargeability represents a social consensus that bankruptcy cannot discharge moral commitments. A fresh start through bankruptcy is meant for the "*honest*, but unfortunate debtor."[548] In this manner, the Code incorporates moral culpability as grounds for denial of discharge.

By making education debt nondischargeable, Congress has linked student loan default together with offenses such as fraud, willful injury, and failure to pay child support.[549] Debtor 1, above, explained how easy it was for her to obtain student loans. All she needed was ten minutes and some computer clicks to become fully funded with loans at the start of each semester. Multiply that by eight semesters and a student borrower can easily incur a lifetime of debt servitude.

540. Charles Jordan Tabb, *The History of Bankruptcy Laws in America*, 3 AM. BANKR. INST. L. REV 5, 13–14 (1995).

541. Grogan v. Garner, 498 U.S. 279, 286–87 (1991).

542. 11 U.S.C. § 523(a)(2)(A), (B) (2012).

543. *Id.* § 523(a)(4).

544. *Id.* § 523(a)(6)

545. *Id.* § 523(a)(9).

546. *Id.* § 523(a)(1).

547. *Id.* § 523 (a)(5), (15).

548. Grogan v. Garner, 498 U.S. 279, 286–87 (1991).

549. *See* Fossey, *supra* note 251, at 33 (Congress placed education debtors in a class with those who commit fraud, embezzlement, breach of fiduciary duty, crimes involving `moral turpitude, etc.).

For Debtor 1, there was a Grand Canyon gap between the ease of incurring her education debt, and her ability to repay it. This situation and hundreds of thousands of others like it segue into the responsibility of creditors in making loans. As Bruce Mann has observed, "[i]f debtors have moral obligations, so much do creditors." [550]

Douglas Baird sees no problem in distinguishing student loans from standard consumer debt because, "unlike ordinary extensions of consumer credit, someone who takes an education loan before going away to college is not making a decision casually. The decision to incur the loan is part of a larger decision . . . that is made only after considerable thought and care."[551] For Baird, it is the aspect of "reflection and deliberation" that allows for the special status of student loans.[552] However, my interviews with student loan debtors convinces me that students do not comprehensively reflect and deliberate when incurring education debt, and that their failure to do so is caused by two key, but flawed, perceptions: (1) students substantially *underestimate* the difficulty in repaying large sums of money, probably because they lack experience in earning and managing a standard adult income and expenses; and (2) students substantially *overestimate* their prospects for getting top grades in school and landing a well-paying job upon graduation.[553] It is not just the imprudent or statistical outliers that do so. Increasingly, the majority of students at many programs make these assumptions, then find themselves in serious debt trouble when they graduate with huge student debt and few job prospects. In a particularly bizarre case of circular misfortune, the Ohio State Supreme Court ruled that a Ohio State law graduate failed the character and fitness qualification and could not sit for the bar exam because he had no feasible plan to repay his $170,000 in student loan debt and $16,500 in credit card debt.[554] In other words, the

550. Bruce H. Mann, *Failure in the Land of the Free*, 77 AM. BANKR. L.J. 1, 7 (2003).

551. Douglas G. Baird, *Discharge, Waiver, and the Behavioral Undercurrents of Debtor-Creditor Law*, 73 U. CHI. L. REV. 17, 28 (2006).

552. *Id.*

553. As one maxim has it, 100% of new students are sure they will be in the top 10% of their class, and 90% of them are wrong.

554. Debra Cassens Weiss, *Law Grad with No Plan to Repay Debt Fails*

debtor was found unfit to become a lawyer because he had too much student loan debt, notwithstanding the fact that he incurred the debt in order to become a lawyer, and by practicing law he could pay the debt.

If a borrower incurred a student loan debt intending to not repay it, the debt would properly be nondischargeable as a debt incurred by fraud. But Debtor 1, above, did not incur her student loan debt with the intent to not repay it, nor did Debtor No. 2, 3, 4, and nearly every other student loan debtor. Ironically, the debtors might almost be better off if they had committed some fraud, rather than incur student loan debt, because there is no statute of limitations for federal education loan debt. There are state and federal statutes of limitations for almost every type of debt and almost every type of crime, the rare exceptions being crimes punishable by death, including murder, espionage and treason. In this way, education debt is viewed through the lens of moral malfeasance in bankruptcy law. It is unlikely that student borrowers consider this perspective when they incur their loans to obtain an education.

*2. Debtor's Prisons Redux*

As the stories of Debtors 1 to 4 attest, education debt represents exceptionally large debt, and for most debtors, incurred at a relatively young age. Other than a home, few people are unlikely to purchase any single thing that is as costly as an education.

For many student borrowers, the same hefty investment required to get an education to earn a livelihood correspondingly creates a lifetime of debt service. The Indentured Generation will be under monthly loan obligations that for decades will preclude purchasing anything comparable in price to the cost of their education. Of course, debtors are obligated to repay debts they incur, but our society sees merit in allowing people in serious, debilitating financial distress to discharge debts in bankruptcy. By excepting education debt from bankruptcy discharge, debtors are given no escape from the financial

*Character and Fitness Mandate*, A.B.A. J. (January 13, 2011), http://www.abajournal.com/news/article/law_grad_with_no_plan_to_repay_debt_fails_character_and_fitness_mandate_ohi

stresses that would otherwise qualify them for discharge. It is disconcerting that the first and second prongs of *Brunner*, together, inherently countenance that a debtor go without a minimal standard of living—no adequate housing, clothing, food, etcetera—for an indeterminate period unless he proves that his situation will never rise above the low minimal standard.[555] This is a coherent description of deprivation. Student borrowers in the Indentured Generation, starting from a young age, will become permanent members of an economic underclass. They are living in American society, but from a financial perspective, always on the outside looking in.

An indentured class is not a good thing for our society to create. As Bruce Mann states, "[w]hether a society forgives its debtors and how it bestows or withholds forgiveness are more than matters of economic or legal consequence. They go to the heart of what a society values."[556] Elizabeth Warren puts it another way:

> Americans need a safety valve to deal with the financial consequences of the misfortunes they may encounter. They need a way to declare a halt of creditor collection actions when they have no reasonable possibility of repaying. They need the chance to remain productive members of society, not driven underground or into joblessness by unpayable debt.[557]

It is fortunate that debtors' prisons are no more, because there would be tens of thousands of potential student loan debtor inmates ready to be sentenced. Yet as a society, we sentence them to a lifelong form of house arrest. It is still an incarceration, one that is not necessarily more moral than a prison of bars and walls.

*3. Participation in Economic Life*

A recent report by the Federal Reserve Bank of New York shows that there are higher rates of consumer debt delinquency and declining rates of new mortgage originations

555. *See supra* Part II.B.4.

556. Mann, *supra* note 550, at 1.

557. Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 492 (1997).

among borrowers with student loan debt.[558] Other financial experts note that higher education debt burdens are disqualifying a generation of young graduates from home ownership.[559] Many commentators argue that to forgive student loan debt and return consumers debtors to normal economic life is an economic imperative. Margaret Howard asserts that student loan debt is not by nature different from any other unsecured debt,[560] that student loan debtors are no more likely than other debtors to abuse the bankruptcy process,[561] and that bankruptcy serves a critical economic purpose in restoring debtors to participation in the "open credit economy."[562] John M. Czarnetsky finds that bankruptcy resolves the tension between "freedom of contract and freedom of action in the market,"[563] and gives debtors a renewed incentive to engage in entrepreneurship and social improvement.[564] John D. Sousa offers a social utility theory to discharge, combining the economic participation arguments of Howard and Czarnetsky, with curing the social malaise caused by severe economic distress:

> [C]onsumers who are freed of constricting debt obligations can take that portion of their incomes once dedicated to attempting to fruitlessly repay their creditors and place this income into the stream of economic commerce. Moreover, freed of this indebtedness, debtors will have every incentive to resume productivity, rather than contemplate idleness if working only produces a return for the creditors.[565]

558. Donghoon Lee, *Household Debt and Credit: Student Loan Debt*, FED. RES. BANK OF N. Y., 18-20 (February 28, 2013), http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf.

559. Kathleen M. Howley, *American Dream Eludes With Student Debt Burden: Mortgages*, BLOOMBERG.COM (April 13, 2013), http://www.bloomberg.com/news/print/2013-04-12/american-dream-eludes-with-student-debt-burden-mortgages.html (noting that higher education debts .

560. Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1086 (1987).

561. *Id.* at 1087.

562. *Id.* at 1048.

563. John M. Czarnetzky, *The Individual and Failure: A Theory of Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 428 (2000).

564. *Id.* at 412.

565. Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge*, 58 U. KAN. L. REV. 553, 597 (2010).

## IV. AMEND THE BANKRUPTCY CODE

A number of solutions have been proposed to address the problem of student loan debt. Many commentators have recommended that student debt be returned to the list of nonpriority general unsecured debt,[566] and a bill has been introduced in Congress to do just that.[567] Even without the student loan discharge exception, bankruptcy courts have discretion to dismiss a petition filed in bad faith,[568] or to deny discharge of a debt incurred by fraud.[569] Restoring the student loan debt discharge would certainly enhance the fresh start purposes of the Code. But allowing student loans to be dischargeable as general unsecured debt could potentially cost the federal government tens of billions of dollars to make good on loan guarantees, so any such action in Congress is unlikely for the foreseeable future.[570]

What about making only private student loans dischargeable? This might strike a useful middle ground, as there are no modification or forgiveness programs for private loans, and lenders can refuse to make new loans if they do not deem the borrower to be creditworthy. The Consumer Financial Protection Bureau has recommended that private student loans be dischargeable,[571] and legislation has been introduced in Congress for this purpose.[572] However, because most loans are federal loans, and in addition, private loans

566. NAT'L ASS'N OF CONSUMER BANKR. ATTY'S, *supra* note 455, at 5; Sarah Edstrom Smith, *Should the Eighth Circuit Continue To Be the Loan Ranger? A Look at the Totality of the Circumstances Test for Discharging Student Loans Under the Undue Hardship Exception in Bankruptcy*, 29 HAMLINE L. REV. 601, 616–18 (2006).

567. H.R.J. Res. 365, 112th Cong. (2011), 2011 CONG US HRES 365 (Westlaw)). A petition was circulated online for supporters to sign. *See* Robert Applebaum, *Want a Real Economic Stimulus and Jobs Plan? Forgive Student Loan Debt!*, SIGNON.ORG, http://signon.org/sign/support-the-student-loan/?source=search (last visited Apr. 13, 2012).

568. 11 U.S.C. § 707(b) (2012).

569. *Id.* § 523(a)(2)(A).

570. Karen Weise, *Bankruptcy Shift Wouldn't Ease Much Student Debt*, BLOOMBERG, (July 27, 2012), http://www.businessweek.com/articles/2012-07-26/bankruptcy-shift-wouldnt-ease-much-student-debt.

571. CONSUMER FIN. PROTECTION BUREAU, PRIVATE STUDENT LOANS (2012), *available at* http://www.consumerfinance.gov/reports/private-student-loans-report/.

572. Private Student Loan Bankruptcy Fairness Act of 2011, H.R. 2028, 112th Cong. (2011).

usually require a cosigner, it is unclear how much of an impact this would have on most borrowers.[573]

Another possibility is that Congress could reinstate a time-lapse discharge. From 1978 to 1990, unless he could prove undue hardship, a debtor had to wait five years after a loan first became due before the debt could be discharged in bankruptcy.[574] From 1990 to 1998 that time was extended to seven years.[575] One commentator has likened time-lapse discharge to the discharge of tax debt, noting that most tax debt can be discharged after three years of its accrual, thus mitigating the soft fraud of new graduates filing for bankruptcy promptly upon graduation.[576]

A more radical idea for funding education is for students to sell an interest in their future earnings either to the institution providing the education[577] or to private equity investors.[578] The repayment period might expire after a set number of years, or not kick in until a certain income threshold is hit.[579] There might even be an Equity College, whose survival depends entirely on the success of its students, which in turn would be based upon how well the college prepared the students.[580] On the one hand, this avoids the problem of the debtor being required to pay the lender a disproportionate share of income in comparison to the debtor's essential living expenses. On the other hand, it creates many concerns. First, although it may be the functional equivalent of some student loan debts, it feels a lot like personal servitude. Second, lenders will seek to make loans to students (1) who have already shown higher earning

573. Weise, *supra* note 570 (the author predicts that because most private debt now requires a cosigner, it is not likely that both the borrower and co-signer will file bankruptcy just to get rid of the debt).

574. 11 U.S.C. § 523(a)(8), *amended by* Pub. L. No. 101-647, § 362(1)-(2) (1990).

575. *Id.*

576. Abbye Atkinson, *Race, Education Loans, & Bankruptcy*, 16 MICH. J. RACE & L. 1, 36-37 (2010).

577. *Selling a Piece of Your Future*, THE ECONOMIST, (Apr. 9, 2012), http://www.economist.com/comment/1354410.

578. David Bornstein, *Instead of Loans, Investing In Futures*, OPINIONATOR, May 30, 2011, *available at* 2011 WLNR 10797026 (Westlaw); Evan Soltas, *The Human Startup*, BLOGSPOT (July 16, 2012), http://esoltas.blogspot.com /2012/07/human-startup.html.

579. Soltas, *supra* note 578.

580. *Id*.

potential, (2) are in institutions with stronger reputations, and (3) are pursuing programs with higher earning capacity. This is, in effect, a front-loaded creditworthiness analysis, which is at odds with the current philosophy of making federal student loans irrespective of creditworthiness. Third, lenders cannot really know the potential and intentions of student borrowers, and higher earning borrowers will end up subsidizing lower earning ones.[581]

Discharge of education loan debt is not likely in the foreseeable future, and as yet, the marketplace has not come up with a solution to student debt that matches the demand for education loans. In the meantime, the Indentured Generation continues to stumble. I propose as a solution amending the Bankruptcy Code in a manner that encourages education lending but that also remains true to the Bankruptcy Code's fundamental purposes.

When a debtor with education loans files bankruptcy, the debtor will note on a statistical summary that there is education debt, as is currently done. And, the debtor will list the debt on Schedule F, and the debt, without more, will not be dischargeable. This is also the same as current practice. However, if the debtor wants any of his education debt discharged, then instead of filing an adversary proceeding to establish undue hardship under § 523(a)(8), the debtor will file a motion to determine the fair market value of each student loan debt, similar to a motion to determine the value of a secured interest under the current § 506. Section 523(a)(8) will be deleted, and a new section added that provides that a claim for an education benefit or loan is nondischargeable to the extent of the value of the claim. This provision would become a new § 512, Claims for Education Loans. A § 512 motion would be raised as a contested matter under Bankruptcy Rule 9014 in a Chapter 7 or Chapter 13 case.

Pursuant to the new § 512, the claim of an education loan or education benefit creditor could be modified by order of the court to reflect the actual fair market value of the claim. The

581. Soltas also points out the problem of asymmetry of information, and suggests that borrowers might actively conceal information from potential lenders. Evan Soltas, *More on the 'Equity College'*, BLOGSPOT (July 17, 2012), http://esoltas.blogspot.com/2012/07/more-on-equity-college.html.

amount of the claim equal to the fair market value would be nondischargeable, while the remaining balance of the claim would be treated as dischargeable, general unsecured debt. In this context, fair market value means the amount that an investor would pay to purchase the respective student loan obligation. The court would fix the fair market value of the debt based on evidence presented by the debtor and creditor at a hearing. Fair market valuation is commonly used to determine the value of secured debt as well as interest rates in Chapter 11 cases, and in some Chapter 13 cases.

It would not be difficult for bankruptcy courts to determine the fair market value of a student loan or benefit claim. There is an active secondary market in bonds backed by bundles of student loans, currently trading over $240 billion in loans annually.[582] Market players have their own formulae for deciding how to value loans. Factors such as finishing with a degree, the type and length of a program, and even graduating on time are variables used by investors in calculating the value of the loan.[583] For example, the historic default rate for many student loans is presumed to be 25% to 30%, but investors in this market calculate that defaults will be 30% to 40% for current graduates.[584] For new private loans, there is also a credit analysis as part of the

582. Matt Wirz, *What Hedge Funds Can Teach College Students*, WALL ST. J., (Nov. 12, 2011), http://online.wsj.com/article/SB10001424052970204224604577030562170562088.html. The secondary student loan market continues to be active. New securitization of student-loan asset backed securities (SLABS) in 2011 was $12 billion, and that number is expected to increase for 2012. STANDARD & POORS, *supra* note 21, at 21. Private student loan ABS for 2012 was $2.8 billion as of June 2012, while $7.8 billion was issuance of term securitizations of pre-2010 loans under U.S. Department of Education Straight-A Conduit and FFELP refinancing. STANDARD & POOR'S, *supra* note 33, at 1.

583. Wirz, *supra* note 582. For example, graduates of technical two-year colleges have far less debt, and skills that may be more employable, making them a better credit risk. *Id.*

584. *Id.* Investors continually review student loan securities, and their value and increase or decrease, based upon such factors as increased rates of default among borrowers in a particular tranche. *See, e.g.*, *Fitch Affirms Sr. Note and Downgrades Sub and Jr. Sub Notes for PARTS Student Loan Trust 2007-CT1*, BUSINESS WIRE, (July 1, 2011), http://www.businesswire.com/news/home/20110701006015/en/Fitch-Affirms-Sr-Note-Downgrades-Jr.-Notes (downgrade due to an increase in defaults to 12.87%); *see also Fitch Affirms All Bonds of SLM Student Loan Trust 2002-7*, CNBC, (July 6, 2012), http://www.cnbc.com/id/48099895 (affirmed based upon sufficient level of credit to cover risk).

underwriting process.[585] One particular nuance in the student loan context is that experts in a student loan discharge hearing should account for the fact that a debtor's other general unsecured debt will be discharged, which may improve the debtor's ability to repay and hence improve the market value of the loan. All together, bankruptcy courts can readily utilize most of the factors used by investors on a daily basis to value billions in student loans on the secondary market to establish the fair market value of student loan debt in bankruptcy.

This approach offers some important advantages over current practice. First, it substitutes a bankruptcy court's subjective determination for that of the market-place in determining what portion of student loan debt can feasibly be repaid and what portion should be discharged. Thus, judges will not have to decide how much debtors and their families need to live on.[586] This will lessen the burden on bankruptcy courts and do away with complicated and inconsistent case precedent. Most important, the proposal will prevent capable debtors from discharging loans that they are able to repay, while at the same time providing a means of escape and financial rehabilitation for student loan debtors facing lifelong debt servitude. Thus, this approach honors the Bankruptcy Code's fundamental purpose of providing the honest but unfortunate debtor a financial fresh start.

There are likely to be a number of outcomes in the near future if the Bankruptcy Code is revised in this manner. The first is that most education loans will be partially, but not fully dischargeable in bankruptcy. This is because a debtor who qualifies for discharge of debt in bankruptcy is, by definition, in financial distress and unable to meet his financial obligations. But many loans will not be fully dischargeable because many debtors, such as chapter 13 debtors, are able to repay at least a portion of their debt. In addition, debtors who obtain relief from student loan debt generally become an improved credit risk. Therefore, there is unlikely to be a wholesale repudiation of all student loan debt in bankruptcy.

585. *Id.*

586. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 297 (3d ed. 1996).

Allowing loans to be dischargeable in bankruptcy based on fair market value will certainly impact the student loan industry. Private student loan lenders will be more credit-sensitive about making loans, and this may impact the availability of non-federal student loan credit. The fair market value test is, in effect, a credit-worthiness test made after a debtor has incurred loans. Faced with that potential, lenders will have incentive to run similar calculations before making the loan. Lenders may become more selective about making loans to students in specific fields or in specific programs if there are fewer jobs for that field or if the dropout rate in that program is high. This may indirectly result in fewer entrants into over-crowded professions or few funds for lower-quality education programs. Market-place Darwinism such as this may well be preferable to a lifetime of insurmountable debt.

With respect to federal loans, lawmakers will have to face a political decision regarding funding and conditions for student loans if the balance in excess of fair market value can be discharged in bankruptcy. This will spark tension with the democratizing premise of the current federal student loan program. There is no evidence that borrowers have abused the right to discharge student loan debt in the past, but education costs and student loan debt were a mere fraction of what they are today. Therefore, the past may not be a reliable guide to what could happen in the future. If there should be a tidal wave of student loan discharge (assuming § 512 takes effect), Congress would have to consider at that point whether to adjust funding for education loans. If the Bennett Hypothesis theorists are correct, then reduced federal student loan credits might be the only thing that could force education costs to level-off, or, optimistically, even decrease. With stable or even lower education costs, education should become more accessible, more democratic. That would be an ironic turn of events, and good news for the Indentured Generation.